

No. 87-654-ASX  
Status: GRANTED

Title: New Energy Company of Indiana, Appellant  
v.  
Joanne Limbach, Tax Commissioner of Ohio, et al.

Docketed:  
October 22, 1987

Court: Supreme Court of Ohio  
Counsel for appellant: Schwartz, Herman  
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NOTE\* Notice of Appeal filed 10/9/87

Entry	Date	Note	Proceedings and Orders
1	Oct 22 1987	G	Statement as to jurisdiction filed.
2	Nov 19 1987		Motion of appellee Joanne Limbach to dismiss or affirm filed.
3	Nov 20 1987		Motion of appellee South Point Ethanol to dismiss or affirm filed.
4	Nov 24 1987		DISTRIBUTED. December 11, 1987
6	Dec 14 1987		PROBABLE JURISDICTION NOTED. *****
7	Jan 15 1988		Joint appendix filed.
8	Jan 15 1988		Brief of appellant New Energy Co. of IN filed.
9	Feb 3 1988	D	Motion of appellees for divided argument filed.
11	Feb 5 1988		Order extending time to file brief of appellee on the merits until February 25, 1988.
12	Feb 5 1988		SET FOR ARGUMENT, Tuesday, March 29, 1988. (2nd case).
14	Feb 19 1988		Record filed.
		*	Certified copy of original record received.
13	Feb 22 1988		Motion of appellees for divided argument DENIED.
15	Feb 25 1988		Brief amici curiae of Natl. Governors' Assn., et al. filed.
16	Feb 25 1988		Brief amici curiae of Idaho, et al. filed.
17	Feb 25 1988		Brief of appellee South Point Ethanol filed.
19	Feb 25 1988		Brief amicus curiae of Illinois filed.
20	Feb 25 1988		Brief of appellee Joanne Limbach filed.
21	Mar 1 1988		CIRCULATED.
22	Mar 7 1988		Record filed.
		*	Certified original record received.
23	Mar 22 1988	X	Reply brief of appellant New Energy Co. of IN filed.
24	Mar 29 1988		ARGUED.

87-654

Supreme Court, U.S.  
FILED

OCT 22 1987

JOSEPH F. SPANIOLO, JR.  
CLERK

No.

IN THE  
**Supreme Court of the United States**  
OCTOBER TERM, 1987

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NEW ENERGY COMPANY OF INDIANA,  
*Appellant,*

v.

JOANNE LIMBACH,  
TAX COMMISSIONER OF OHIO, and SOUTH POINT ETHANOL,  
*Appellees.*

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On Appeal from the Supreme Court of Ohio

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**JURISDICTIONAL STATEMENT**

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## QUESTIONS PRESENTED

Prior to 1985, Ohio granted a credit to the motor vehicle fuel tax for gasohol, which is a 90-10 blend of gasoline and ethanol. On December 20, 1984, Ohio amended the statute, effective January 1, 1985, by denying the credit to gasohol containing ethanol produced in another state, unless the producer state grants at least as high a credit to gasohol sold there containing ethanol produced in Ohio.

The following questions are presented by this appeal:

1. Does the Commerce Clause allow Ohio to insist on such forced reciprocity even if, as the trial court found, its practical effect is to bar and/or remove from the Ohio market ethanol produced in those states that choose not to give such a credit?

2. Is a reciprocity provision enacted for the purpose of promoting domestic industry and to induce other states to grant reciprocal tax credits consistent with the Commerce Clause?

3. Is the reciprocity provision constitutional because at least some of the ethanol produced outside Ohio is eligible for the tax credit and can enter the Ohio market, even though because of that provision, ethanol produced in many other states cannot?

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*Appellees.*

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**On Appeal from the Supreme Court of Ohio**

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**JURISDICTIONAL STATEMENT**

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Appellant New Energy Co. appeals from a final order of the Supreme Court of Ohio, on rehearing, rejecting a challenge to Ohio Revised Code 5735.145(B), an amendment to the Ohio motor fuel tax enacted December 20, 1984 and effective July 1, 1985, which amendment conditioned the grant of a credit to such tax for gasohol containing ethanol produced in a state other than Ohio, on the availability of a similar credit for Ohio-produced ethanol in such other state. The Supreme Court of Ohio held that the statute did not violate Article I, sec. 8, cl. 3, the Commerce Clause, of the United States Constitution.

**OPINIONS BELOW**

The opinion of the Ohio Supreme Court on rehearing is reported at 32 Ohio St. 3d 206, and is reprinted at Appendix 1a. The original decision of the Ohio Supreme Court has not been reported and is reprinted at Appendix

20a. The opinion of the Tenth Appellate District of the Court of Appeals of Ohio is not officially reported and is reprinted herein at Appendix 35a. The opinion and decision of the Court of Common Pleas of Franklin County, Ohio is not officially reported and is reprinted herein at Appendix 56a.

### JURISDICTION

The Ohio Supreme Court rendered its opinion and entered a final judgment on rehearing on September 2, 1987. A Notice of Appeal to this Court was timely filed with the Ohio Supreme Court on October 9, 1987. This appeal is docketed within 90 days of the rendering of the Ohio Supreme Court's decision and judgment on rehearing, and the jurisdiction of this Court is invoked under 28 U.S.C. sec. 1257(b).

### CONSTITUTIONAL AND STATUTORY PROVISIONS

Article I, sec. 8, cl. 3 of the United States Constitution provides that:

1. The Congress shall have power . . . to regulate commerce with foreign nations, and among the several States, and with the Indian tribes.

Ohio Revised Code 5735.145(b) is reprinted herein at App. 77a.

### STATEMENT OF THE CASE

Appellant New Energy Company of Indiana (New Energy) is an Indiana limited partnership engaged in the business of manufacturing ethanol and distributing it in interstate commerce. Ethanol is a 199 proof alcohol, which is derived from, among other sources, corn. The corn is treated with enzymes that convert the starch into sugar and ultimately into alcohol. Ethanol is mixed with gasoline in a 10/90 percent ratio to form a blend commonly referred to as gasohol. New Energy's production facility became operational in October 1984.

New Energy's ethanol manufacturing plant is located in South Bend, Indiana, and one of its primary markets, prior to the enactment by the Ohio General Assembly of R.C. 5735.145(B), was the State of Ohio. It was then distributing approximately 25% of its output to Ohio and reasonably anticipated that when its new plant reached full production capacity, 35% of its total output would be distributed to Ohio. Prior to the enactment of R.C. 5735.145(B) New Energy was distributing to Ohio fuel dealers in excess of 12 million gallons of ethanol per year. The enactment of the challenged legislative amendment has, for all practical purposes, prevented New Energy from distributing any of its ethanol in interstate commerce from Indiana to Ohio. Intervenor-appellee South Point Ethanol is an Ohio based ethanol facility that competes with New Energy for the sale of ethanol in interstate commerce. It lobbied heavily for the enactment of R.C. 5735.145(B).

As originally enacted in 1981, R.C. 5735.145 granted a credit to fuel dealers against fuel taxes for fuel containing a blend of not more than 10% of ethanol. This credit was granted regardless of where the ethanol was produced. Effective January 1, 1985, the Ohio General Assembly on December 20, 1984 amended that statute, adding subsection (B) which stipulated that qualified fuel otherwise eligible for the credit "shall not contain ethanol produced outside Ohio, unless the tax commissioner determines that the fuel claimed to be eligible for credit contains ethanol produced in a state that also grants an exemption, credit, or refund from such state's motor vehicle excise tax or sales tax for similar fuel containing ethanol produced in Ohio." It is this January 1, 1985 statutory amendment that is subject to constitutional challenge as being violative of the Interstate Commerce Clause.

The enactment of the challenged amendment has had the practical effect of barring from Ohio any out-of-state ethanol producer located in a state that does not grant

a tax credit to any ethanol producer. Indiana is a state that does not provide such credits to any producers, regardless of state of origin. Thus, dealers who obtain their ethanol from New Energy would be ineligible for the Ohio credit. At all times relevant, the Ohio credit was in the amount of \$.25 per gallon of ethanol. The evidence made it quite clear that no ethanol producer could continue to distribute in a state where it was subjected to such a penalty for its home state's failure to provide what Ohio R.C. 5735.145(B) required.

Shortly after the enactment of R.C. 5735.145(B), New Energy filed its Complaint in the Franklin County Common Pleas Court seeking a declaratory judgment that the forced reciprocity tax credit amendment was unconstitutional as violative of the Interstate Commerce, Privileges and Immunities and Equal Protection clauses. Thereafter, New Energy abandoned the Equal Protection and Privileges and Immunities Claims and proceeded solely under the Commerce Clause.

The Franklin County Common Pleas Court tried the case on an expedited basis and heard evidence on March 1, 1985 and March 29, 1985. The trial court decided the case on the basis of that evidence and on the basis of agreed findings of facts submitted by New Energy, the State of Ohio Tax Commissioner, and South Point Ethanol. The trial court found this to be "a very close case", but held that R.C. 5735.145(B) did not violate the Commerce Clause of the United States' Constitution because of a strong presumption in favor of constitutionality. The trial court further found that "the legislature's purpose of promoting domestic industry and to affect the policies of other states to grant reciprocal tax credits, is a legitimate purpose—at least debatably". It further found that "in all likelihood, no dealer will purchase plaintiff's product because it is not subject to the tax credits." This decision of the trial court was affirmed by a 2-1 split

decision of the Tenth Appellate District of the Court of Appeals.

When the appeal came before the Supreme Court of Ohio, it rendered an opinion on December 26, 1986, which reversed the Court of Appeals and declared R.C. 5735.145(B) to be violative of the Commerce Clause of the United States' Constitution. The Supreme Court of Ohio reached that decision by a 4-3 vote. However, 2 of the justices in the majority (Chief Justice Frank J. Celebrezze and Justice Clifford Brown) failed of reelection and were replaced in January, 1987, by Chief Justice Thomas Moyer and Justice Herbert Brown. South Point Ethanol filed a Motion for Rehearing. None of the justices who concurred in the majority opinion declaring this legislation violative of the Commerce Clause voted for the rehearing. However, the three justices who dissented from the December 26, 1986, opinion, were joined in voting for the rehearing by newly elected Chief Justice Moyer, who was not a member of the Court when the case was originally argued or decided.

On January 21, 1987, the newly constituted court granted rehearing of this case as well as many others, vacated the earlier decision, and ordered publication of the original opinion withheld. New Energy moved for reconsideration on the grounds that Chief Justice Moyer was not qualified to move for reconsideration or to join in vacating the earlier decision. The Ohio Supreme Court had a well established precedent of newly elected justices not voting on reconsideration motions affecting decisions of the prior court. Newly elected Justice Herbert Brown honored prior precedents and did not participate in rehearing proceedings.

Shortly after the Motion for Rehearing was granted, press reports appeared raising questions about Chief Justice Moyers' participation in the *New Energy* and certain other cases. The Chief Justice thereupon *sua*

*sponte* withdrew from the case. A motion by New Energy to cause such withdrawal to be effective *nunc pro tunc* was denied, and the Chief Justice's vote for rehearing remained in force. Thereafter the case was rebriefed and argued before the new Supreme Court. This led to the 4-3 split decision which upheld the constitutionality of R.C. 5735.145(B).

### THE QUESTIONS PRESENTED ARE SUBSTANTIAL

On rehearing, the Ohio Supreme Court determined that R.C. 5735.145(B), the 1984 amendment to the Ohio gasohol tax credit statutes, did not violate the Commerce Clause. The Ohio Court concluded that the amendment was "not protectionist in either its purpose or effect," App. 4a. The Court did find "the issue of forced reciprocity . . . a thorny problem," because such statutes are subject to "the strictest scrutiny," but it concluded that the statute was nevertheless constitutional because "here [t]here is no bar, direct or indirect, on interstate commerce." App. 8a, 11a.

Other objections to the amendment were dismissed with the conclusion that "R.C. 5735.145 is not protectionist and is not unreasonably burdensome on interstate commerce. It does not give an advantage solely to Ohio producers, and does not interfere with the flow of ethanol into Ohio by out-of-state suppliers." App. 8a-9a.

On all three issues—reciprocity, protectionist purpose and burdensome effects—the Ohio Supreme Court erred, and in a manner that conflicts with numerous decisions of this Court.

#### I. The Ohio Supreme Court's Decision On Reciprocity Conflicts With The Decisions Of This Court.

The Ohio Supreme Court's discussion of reciprocity opens somewhat ambiguously with a concern that if Ohio's reciprocity statute is struck down, then so will the

reciprocity statutes of "about thirty states." App. 8a. Apart from the fact that only a few states have *reciprocity* statutes—the rest give credits but do not exact reciprocity—the constitutional significance of this is unclear since "about thirty states" have no more of a right to discriminate and force reciprocity on the other twenty, than one state may wish respect to the other forty-nine.

This is obviously a minor aspect of the Court's discussion. The essence of the Ohio Supreme Court's decision on reciprocity appears in its observation that:

"the bulk of ethanol and gasohol sold in Ohio is obtained primarily through interstate commerce, whereby ethanol is shipped into Ohio from Illinois and Tennessee. Thus, New Energy's inability to compete in the Ohio market will not affect the flow of ethanol through inter-state commerce into Ohio." App. 9a.

But this Court has said many times that there need not be a complete ban on all out-of-state business, either with respect to the number of out-of-state competitors affected, or with respect to how severely a particular business is disadvantaged, Ohio has no more right to discriminate against businesses from another state than did North Carolina in *Hunt v. Washington Apple Advertising Comm'n*, 432 U.S. 333 (1977), Mississippi in *Great A&P Tea Co. v. Cottrell*, 424 U.S. 366 (1976), or New York in *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318 (1977).

Indeed, this Court explicitly noted in *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 146 (1970), that only one company, and not the entire industry was affected. In *Hunt*, the impact on the products of only one state—Washington—was at issue; in *Lewis v. BT Investment Mgrs., Inc.*, 447 U.S. 27, 32, 39-40 (1980), the statute was actually aimed at only one company. And in *Great*

*A&P Tea Co.*, Louisiana milk was largely<sup>1</sup> excluded, but some eight states had reciprocity agreements with Mississippi and milk companies from those states were able to come into Mississippi. See Brief of Appellee in *Great A&P Tea Co. v. Cottrell* 6-7. See also *Miller v. Publicker Industries, Inc.*, — Fla. —, 457 So. 2d. 1374 (Fla. S. Ct. 1984) (foreign producers excluded, but not domestic out-of-state companies).

Despite the presence of some out-of-state competitors or the ability of some out-of-staters to compete on an equal basis with in-staters, the Court has nevertheless insisted on "the strictest scrutiny" for forced reciprocity provisions, see *Sporhase v. Nebraska*, 458 U.S. 941, 957 (1982), as the Ohio Supreme Court recognized. This is because it is the creation of just such preferential trade areas, in which firms from other states may enter but only in return for favorable treatment for the in-stater in those other states, that this Court has frequently warned against. See, e.g., *Great A & P Tea Co.*; *Dean Milk Co. v. Wisconsin*, 340 U.S. 349 (1951). Thus, speculation that other out-of-state producers may pick up appellant's share of the Ohio market, see Court of Appeals opinion, App. 46a, a speculation for which there is no evidentiary support, is constitutionally irrelevant.

In any event, Ohio may not determine which out-of-state business it will let in by insisting on out-of-state benefits for its own producers as a condition of entry.<sup>2</sup>

<sup>1</sup> Because of a "grandfather clause", even some milk from Louisiana and Alabama which had no reciprocity agreements with Mississippi continued to come in. *Great A&P Tea Co. v. Cottrell*, 383 F.Supp. 569, 572 (1974).

<sup>2</sup> This is one respect in which *Exxon Corp. v. Maryland*, 437 U.S. 117 (1978), differs significantly from this case, for in *Exxon*, all refined gasoline came in from out-of-state, and no out-of-staters were benefitted in return for benefits to domestic business. Whatever benefits accrued to some out-of-staters at the expense of others was purely fortuitous and determined by factors wholly unrelated

Nor is it relevant that in *Hughes v. Oklahoma*, 441 U.S. 322 (1979), *Sporhase*, *Dean Milk*, and *Great A&P Tea Co.*, the "ban" on interstate commerce was in the form of an absolute prohibition on entry, whereas here it is in the form of a discriminatory tax. This Court has recognized no distinction between taxes that make out-of-state entry difficult or impossible, on the one hand, and absolute bans, on the other, but has treated the two forms of barrier identically. See, e.g., *Nippert v. Richmond*, 327 U.S. 416, 426 (1946) where, discussing barriers to entry the Court said, "Nor may the prohibition be accomplished in the guise of taxation, which produces the excluding or discriminatory effect." See also, *Bacchus Imports Ltd. v. Dias*, 468 U.S. 263 (1984); *Boston Stock Exchange*; *Welton v. Missouri*, 91 U.S. 272 (1876); *Darnell & Sons v. Memphis*, 208 U.S. 113 (1908); *Best & Co. v. Maxwell*, 311 U.S. 454 (1940); *Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64 (1963). As Chief Justice John Marshall said over 150 years ago, "The power to tax is the power to destroy." *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 431 (1819). Here the trial court found, and it is undisputed, that Ohio's forced reciprocity amendment has a "major impact on its [plaintiff's] business in Ohio . . . [for] in all likelihood, no dealer will purchase plaintiff's product because it is not subject to the tax credit" App. 58a, 62a; see also the Ohio Supreme Court's reference to "New Energy's inability to compete in the Ohio market." App. 9a. As the dissent below observed:

In numerous cases, the United States Supreme Court has invalidated discriminatory state taxes without

to the well-being of domestic competitors, for there were none. See *Lewis v. BT Inv. Mgrs., Inc.*, 447 U.S. at 42 (no discrimination "among affected business entities according to the extent of their contacts with the local economy.") Here, the determination of which out-of-stater benefits is related entirely to the benefits to the local competitor.

requiring that they be so drastic as to erect an impenetrable barricade to commerce at the state border. See, e.g., *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984); *Maryland v. Louisiana*, 451 U.S. 725 (1981); *Boston Stock Exchange, supra*.<sup>3</sup>

<sup>3</sup> State regulations, as opposed to taxes, also need not effect a total ban upon importation to impermissibly burden or discriminate against interstate commerce. See *Hunt v. Washington State Apple Advertising Comm.*, 432 U.S. 333 (1977), wherein the Court invalidated a facially neutral North Carolina statute requiring closed containers of out-of-state apples to bear no quality grade markings showing other than the applicable federal grade. Such regulation plainly did not completely ban the importation of out-of-state apples, but it did put their growers at a competitive disadvantage.

App. 17a-18a. Such a "competitive disadvantage" on some out-of-state businesses is enough to condemn a statute.

Nor is it relevant how great the disadvantage. As this Court said in *Westinghouse Elec. Corp. v. Tully*, 466 U.S. 388, 407 (1984):

When a tax, on its face, is designed to have discriminatory economic effects, the Court "need not know how unequal the Tax is before concluding that it unconstitutionally discriminates." *Maryland v. Louisiana*, 451 U.S. [725] at 760.<sup>13</sup>

<sup>13</sup> The extent of the discrimination does not affect our analysis.

In other respects as well, the Ohio Supreme Court's reasoning and decision are inconsistent with this Court's unanimous decision in *Great A&P Tea Co.* Some of these aspects will be explored in detail below, but these points may be noted here:

- In both cases, the out-of-state competitor was injured because the statute a issue makes eligibilly for enry dependent on what the out-of-state legislature does, a

matter beyond the affected businesses' power. In *Great A&P Tea Co.*, the A & P Co. tried to get Louisiana to enter a reciprocity agreement but failed, 424 U.S. at 369 n.4, and here, New Energy has "no power to demand that [Indiana] enter into a reciprocity agreement with" Ohio, see *Great A&P Tea Co. v. Cottrell*, 383 F. Supp. 569, 573 (D. Miss. 1974) (3 judges) and adopt a motor vehicle fuel tax credit equal to Ohio's.

- In both cases, the courts upholding the statute seemed to be blaming the adverse effect on the foreign state. Thus, there are hints in the lower court opinions and even in the Ohio Supreme Court that Indiana did something wrong or blameworthy in abolishing the tax credit and in providing a small temporary subsidy to ethanol manufacturing facilities, compare *Great A&P Tea Co.*, 383 F. Supp. at 575 n.2, with App. 9a; 45a-46a; 65a, a subsidy which was eliminated as of July 1, 1986, and no longer exists. The legitimacy of this subsidy is, of course, not at issue here and in any event, as this Court ruled in *Great A&P Tea Co.*, if a state does do something another state considers wrong, the recourse is not economic reprisal, but a law suit. 424 U.S. at 379-80.
- In both cases, a specious health argument was presented. It was rejected in *Great A&P Tea Co.*, for, as here, the statutory provision in question actually militated against the purported improvement in health conditions, see point II below, thereby exposing the meretriciousness of the claim.

Most importantly, both cases rely on the danger of "balkanization" of the national economy, of retaliations and reprisals, that the Court in *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511 (1935); *Great A & P Tea Co.*, *Dean Milk, Hughes v. Oklahoma*, *Boston Stock Exchange*, and

elsewhere has warned against. In *Armco, Inc. v. Hardesty*, the Court also insisted that a tax have "what might be called 'internal consistency—that is, the [tax] must be such that, if applied by every jurisdiction,' there would be no impermissible interference with free trade." 467 U.S. 638, 645 (1984). See also *Tyler Pipe Industries v. Washington State Dept. of Revenue*, 107 S.Ct. 2810, 2820 (1987); *American Trucking Ass'ns, Inc. v. Scheiner*, 107 S.Ct. 2829 (1987). Here, if reciprocity were insisted upon by every state, free trade areas would be created in which only those businesses whose state gave exactly the same amount of tax credit to out-of-staters would be able to compete fully in each other's states. Thus, if Indiana gave no credit, Illinois gives only a 1¢ credit, and Ohio and Kentucky each give a 4¢ credit, then (1) Indiana businesses are at a competitive disadvantage in the other three states; (2) Illinois businesses would be able to compete on an even basis only in Indiana and Illinois; and (3) Ohio and Kentucky businesses will have an advantage in the Ohio and Kentucky markets. See also *Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. at 72; *Columbia Steel Co. v. State*, 30 Wash. 2d 658, 662-64 (1948), cited in *Armco v. Hardesty*, 467 U.S. at 645 n.8.

Thus, the actual effect of the Ohio reciprocity provision would "depend on the shifting incidence of the varying tax laws of the various states at a particular moment." The effect of Ohio R.C. 5735.145(B) on Indiana producers would have been different in 1983, when Indiana gave a credit, from what it was in 1984, when Indiana did not, and the effect on Illinois producers is different now that Illinois has reduced its credit, from what it was before the reduction. "The immunities implicit in the Commerce Clause and the potential taxing power of a state could hardly be made to depend, in the world of practical affairs, on such variable relationships." *Freeman v. Hewitt*, 329 U.S. 249, 256 (1946); *Armco v. Hardesty*, 467 U.S. at 648; *Tyler Pipe Ind. v. Washington State Dept. of Revenue*, 107 S.Ct. at 2817 n.11.

Reciprocity conditions are "explicit barrier[s] to commerce between . . . states," *Sporhase v. Nebraska*, 458 U.S. at 957, and, contrary to the decision of the Ohio Supreme Court, it is irrelevant whether all or only some interstate commerce is affected and whether the provision creates an absolute bar or only a competitive disadvantage. It is thus hardly surprising that of the four public authorities who have analyzed the constitutionality of this type of statute, only the Ohio courts have upheld it and by the slimmest of margins; an Illinois version of this statute was struck down last year, *Russell Stewart Oil Co. v. Illinois*, 85 CH 8959 (Cir. Ct. Cook May 7, 1986), *appeal pending*, and the Attorneys General of Tennessee, and Illinois agree. (App. 68a-77a)

This case is on all fours with *Great A&P Tea Co. v. Cottrell*, except that this case involves a tax and *Great A&P* involved a formal barrier. But that is not a difference that makes a constitutional difference.

## II. The Purposes For Which R.C. 5735.145(B) Was Enacted Are Not Consistent With The Commerce Clause.

Although South Point Ethanol and the State have claimed that the improvement of health in Ohio was a purpose of the 1984 amendment, the trial court did not include this among the purposes that it found. Instead, it found two other purposes, both of which are proscribed by the Commerce Clause: "promoting domestic industry and to affect the policies of other states to grant reciprocal tax credits." App. 63a (emphasis in original). The trial court considered these "debatably" legitimate, but they are not even that.

"Promoting domestic industry" is a facially obvious purpose of Ohio R.C. 5735.145(B), and the record reinforces that. On its face, the reciprocity provision gives Ohio producers a competitive advantage over foreign-state producers, unless the foreign state assists them in competing there. If the latter state does not surrender

to this pressure on its producers, those producers are at a competitive disadvantage vis-a-vis the local competitor.<sup>3</sup>

The record facts are particularly illuminating on this issue. Intervenor South Point Ethanol, the sole Ohio ethanol producer and a key figure in the enactment of the 1984 reciprocity amendment (See Hearing of Mar. 29, 1985, pp. 38-39, 57, 60; the two hearings will hereinafter be referred to as "Mar. 1 Hg. ——" and "Mar. 29 Hg. ——" ), has an annual capacity of some 60,000,000 gallons of ethanol, of which 41% were sold in the Ohio market in 1984, or some 22-23 million (id. at 52); its principal owners are Ashland Oil Co. and the Ohio Farm Bureau. New Energy, with approximately the same capacity as South Point, considered Ohio a potential major market and planned to sell approximately 1.7 million gallons a month to wholesalers and retailers in Ohio or about 20.4 million gallons annually (Mar. 1 Hg. 15-16). New Energy thus presented a direct threat to South Point. Indeed, South Point's sales had already begun to fall in 1985, after New Energy, whose production facilities became operational in October 1984 (two months before enactment of RC 5735.145(B)), came into the market and while New Energy was still eligible for the Ohio credit. (Mar. 29 Hg. 52).

Nor is South Point Ethanol simply another private business to the Ohio legislature. The State of Ohio has a major interest in its success, for the company, which was formed in 1981 when the Ohio economy was seriously depressed, provides 185 jobs in an area with the second highest unemployment rate in the state. It has a payroll of \$6 million annually, and it provides additional employment for outside consultants; South Point also buys a great deal of corn from Ohio farmers. (Mar. 29 Hg. 50) Finally, the State of Ohio Public Employees Retire-

<sup>3</sup> They are also at a disadvantage vis-a-vis non-Ohio competitors whose home states do give a subsidy equal to Ohio's, but as noted above, that is irrelevant, for not all out-of-staters need be disadvantaged for the Commerce Clause to be violated.

ment System has loaned South Point \$23.5 million to retrofit and operate its plant. Ohio's "promoting [this particular] domestic industry" is thus very understandable.

Such a goal may not be pursued by means that discriminate against out-of-state business, as this Court emphasized in *Bacchus Imports* just a few years ago. There the State of Hawaii tried to assist a "financially troubled" local business (though there is no evidence that South Point is in trouble) and the impact on out-of-state businesses was very small. Nevertheless, the Court reiterated that "States may not 'build up [their] domestic commerce by means of unequal and oppressive burdens upon the industry and business of other States. *Guy v. Baltimore*, 100 U.S. 434, 25 L.Ed. 743 (1880)." Indeed, a state may not try to nullify another state's competitive edge by discriminatory taxes that merely seek to "equalize." *Deukmejian v. Nat'l Meat Ass'n*, 734 F.2d 656 (9th Cir. 1984), *aff'd*, 105 S.Ct. 768 (1985) *Armco v. Hardesty*, *supra*; *General Motors Corp. v. Washington*, 377 U.S. 436, 461 (1964) (Goldberg, J., dissenting) ("A state therefore should not be enabled to put out-of-state producers . . . at a disadvantage by imposing a tax to 'equalize' their costs with those of local businessmen who would otherwise suffer a competitive disadvantage because of the state's own taxation scheme.")

In *Bacchus Imports*, the Court also rejected the argument that Hawaii had no "discriminatory intent," the Court saying, "If we were to accept that justification, we would have little occasion ever to find a statute unconstitutionally discriminatory . . . [for] virtually every discriminatory statute . . . can be viewed as conferring a benefit on one party and a detriment on the other in either an absolute or relative sense." 468 U.S. at 273.

"To affect the policies of other states to grant reciprocal tax benefits," the other judicially determined pur-

pose for the Ohio statute, is equally unacceptable under the Commerce Clause. Ever since *Baldwin v. Seelig*, it has been undisputed that a state "has no power to project its legislation" into another state to force the latter to adhere to the first state's policies. And the record makes clear that this was indeed Ohio's purpose. As witnesses for both New Energy and South Point Ethanol testified, South Point Ethanol, through its General Manager Lauren Hill, was "lobbying heavily for it [R.C. 5735.145(B)] so they would put pressures on Indiana and perhaps on me [New Energy's President] for some number in Indiana for them at the pump." (Mar. 29 Hg. 39). South Point General Manager Hill, who testified for South Point Ethanol at the hearings on the 1984 amendment, confirmed this with the following testimony:

Q. Basically your support of the reciprocity clause was for the purpose of having Ohio legislation that would put pressure on Indiana to pass legislation?

A. Well, my support of the, including the reciprocity clause with all of these changes was as an incentive to all states to enact all legislation that would promote the sale of ethanol in their states.

Mar. 29 Hg. 60. See also *id.* at 57. Obviously, the "incentive" was the "pressure" created by putting Indiana ethanol producers like New Energy at a competitive disadvantage with Ohio producers like South Point Ethanol in the Ohio ethanol market, unless Indiana did what Ohio wanted it to do.

As this Court said in *Great A&P*, while reciprocity is acceptable, "forced reciprocity" is not. "One state may not put pressure of that sort upon others to reform their economic [or other] standards." *Baldwin v. Seelig*, 294 U.S. at 524. See also *Brown-Forman Distillers v. N.Y. St. Liquor Auth.*, 106 S.Ct. 2080 (1986) (New York cannot force producers in other states to give up their competitive advantage).

In the court below, the State and South Point Ethanol tried to argue that the amendment was passed to increase the use of ethanol and thereby reduce pollution in Ohio. It will be noted that neither the trial Court nor the Court of Appeals accepted this contention, and in the Ohio Supreme Court there is only a passing reference to it, somewhat ambiguously suggesting this as one of the purposes.<sup>4</sup>

The record is barren of any support for this contention apart from a few almost casual references to the advantages of lead-free gasoline. Not only did the trial court and the Court of Appeals almost explicitly refuse to find this as a purpose,<sup>5</sup> but it is patently implausible that this was a purpose. If Ohio wants to encourage the use of ethanol, Ohio would not exclude any ethanol producer from *anywhere*, by denying the credit. Nor would it deny the credit to ethanol businesses whose states have used methods other than a tax credit to promote the use of ethanol. Moreover, Ohio would not insist that any tax credit granted by another state be as high as Ohio's for the other state's ethanol business to avoid being put at a competitive disadvantage in Ohio.

Indeed, if Ohio were really serious about using the credit to encourage the use of ethanol, it would not limit the credit to ethanol made with grain—which is produced in Ohio—and exclude ethanol made from beet or cane sugar, *i.e.*, ethanol not made in Ohio. It would not limit its credit to ethanol made from plants fired with coal—which Ohio mines—or wood and exclude ethanol made

<sup>4</sup> See the passing reference to "Ohio's interest in reducing lead pollution." App. 10a.

<sup>5</sup> The trial court's finding of purposes, quoted above, came immediately after stating appellees' health purpose claim and did not include health among its findings, while the Court of Appeals nowhere mentioned health as a purpose. See App. 42a (stating the purposes).

from plants that are gas-fired. And it would not limit the grant to plants with a capacity below 200,000,000 gallons. As the Court noted in *Great A&P, Hunt, Westinghouse*, and many other cases, the state's argument would be more persuasive if the provision in question actually implemented the asserted policy goal.

Even if there were a legitimate health goal, it must be sought by the "least restrictive alternative," in keeping with "the strictest scrutiny," applicable to such facially discriminatory legislation. *Dean Milk*, 340 U.S. at 354; *Baldwin v. Seelig*, 294 U.S. at 524. As the above paragraph indicates, there are many other ways that are less harmful to commerce to promote the use of ethanol.

### III. The Effect Of R.C. 5735.145(B) Is To Burden Commerce Excessively.

Even if, unlike R.C. 5735.145(B), a statute regulates evenhandedly and treats all equally, there may still be a violation of the Commerce Clause if "the burden on interstate commerce exceeds the local benefits." *Pike v. Bruce Church*, 397 U.S. at 142. The only legitimate "local benefits" that are even remotely relevant are health-related, since protecting local industry at the expense of interstate commerce, or trying to force other states to provide benefits to that local industry, are each illegitimate purposes. Here, the burden far exceeds any possible benefit for the reasons discussed earlier.

The Ohio Supreme Court sought to buttress its conclusion that there was no excessively harmful effect on commerce by positing a hypothetical case in which Ohio R.C. 5735.145(B) was enacted, even though no Ohio firm produced ethanol. In that case, all the ethanol would come from out-of-state firms entitled to the full discount and "producers from states without a reciprocal program would, as appellant, still be at a disadvantage"—an admission, incidentally, that the statute does disadvantage

appellant. If an Ohio producer then enters the market, it is on an even basis with the other competitors in the market, and such "identity of treatment for in state and out-of-state producers is the very essence of the Supreme Court's standard for 'evenhandedness.'" App. 8a.

Hardly. Apart from the rather dubious premise that such a statute would be passed if there were no Ohio producers to benefit (the trial court found, of course, that the very purpose of the statute was to benefit an existing Ohio producer) the Ohio Supreme Court's logic would explain away every reciprocity cases like *Great A&P Tea Co.*, as well as other cases such as *Hunt*, *Lewis v. BT Inv. Mgrs., Inc.*, and *Baldwin v. Seelig*, where a state discriminates against some but not all interstate commerce. Thus, if there were no North Carolina apple growers, only Washington apples would be at a disadvantage and apples from other states outside North Carolina would occupy the market on an even basis with North Carolina's apples when the latter enter the market. Similarly, if there were no Mississippi milk producers, milk from states that accept the reciprocity condition would come into Mississippi, but not milk from those states like Louisiana and Alabama that had refused to do so, and when Mississippi started to produce milk, producers from the first group of states would be treated the same as Mississippi producers. And finally, if there were no milk producers in New York, producers from states where the milk was priced no lower than New York's price floor would occupy the New York market, and the subsequent entry of a New York producer would also treat them all "evenhandedly."

The fallacy in the example is, of course, the unrealistic assumption that a statute geared to the existence of a domestic producer and explicitly designed to assist such producers when selling in other states (apart from any purpose in protecting the local market) would be applied in a situation where there is no local producer. In this

respect, Ohio R.C. 5735.145(B) differs from the statute in *Exxon v. Maryland* which was passed in the absence of any Maryland competitor and was in no way designed to help local stations as opposed to non-refiner or producer-owned stations. Indeed, it has been pointed out that the very same statute was enacted in states where there were local refiners or producers who were thereby forced to give up their stations. See Note, *The Supreme Court, 1977 Term*, 92 HARV. L. REV. 66, 71 n.40 (1978).

The statute in *Exxon* was designed for certain legitimate economic purposes in no way related to competition between in-state and out-of-state competitors. Whatever incidental harm there was to commerce was not only minor and fortuitous but probably unavoidable if the service station industry was to be restructured so as to exclude refiners and producers, no matter what their home state, from service station ownerships. The statute therefore met the "least drastic alternative" requirement of *Dean Milk*.

The same holds for *Minn. v. Clover Leaf Creamery Co.*, 449 U.S. 456 (1981) and *CTS Corp. v. Dynamics Corp.*, 107 U.S. 1637 (1987), which also involve even-handed treatment that is indifferent to the source of the competing entities. As the dissenting Justice Brown pointed out below:

"In stark contrast with the statutes [in the above three cases], R.C. 5735.145(B) contains an *explicit* distinction between ethanol produced in Ohio and ethanol produced in states not granting a reciprocal tax credit. R.C. 5735.145(B) is thus plainly discriminatory on its face. Repetitious assertion by the majority that R.C. 5735.145(B) regulates 'even-handedly' is no substitute for analysis of the law."

## CONCLUSION

For the foregoing reasons, this Court should note probable jurisdiction of this appeal.

Respectfully submitted,

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Dated: October 22, 1987

## **APPENDIX**

APPENDIX

SUPREME COURT, JANUARY TERM, 1987  
[32 Ohio St. 3d]

Counsel for the Parties

NEW ENERGY COMPANY OF INDIANA,  
v. Appellant,  
LIMBACH, TAX COMMR., et al.,  
Appellees.

[Cite as New Energy Co. of Indiana v.  
Limbach (1987), 32 Ohio St. 3d 206.]

*Taxation—Commerce Clause—R.C. 5735.145—Provision  
providing a tax credit for out-of-state producers of  
ethanol if reciprocal tax credit exists for Ohio produ-  
cers constitutional.*

O.Jur 2d Taxation § 231.

R.C. 5735.145 is neither protectionist nor unreasonably  
burdensome on interstate commerce. It does not give  
an advantage solely to Ohio producers, and does not  
interfere with the flow of ethanol into Ohio by out-of-  
state suppliers.

(No. 86-784—Decided September 2, 1987.)

APPEAL from the Court of Appeals for Franklin County.

ON REHEARING.<sup>1</sup>

The sole issue before this court is the constitutionality  
of R.C. 5735.145 which provides a tax credit for Ohio

<sup>1</sup> A motion for rehearing was granted on January 21, 1987. The  
initial opinion in this case announced December 26, 1986 was va-  
cated and publication thereof was ordered withheld on February  
25, 1987.

producers of ethanol, and R.C. 5735.145(B) which grants the tax credit to out-of-state producers of ethanol if their state grants a reciprocal tax credit, exemption or refund for Ohio-produced ethanol.

Ohio requires motor vehicle fuel dealers to pay a tax on all motor vehicle fuel sold. R.C. 5735.145 grants a tax credit to fuel dealers who distribute and sell gasoline to which has been added ten percent by volume of ethanol, commonly referred to as "gasohol." The tax credit is twenty-five cents per gallon of ethanol used, thus making the cost of a gallon of gasohol two and one-half cents cheaper.

Appellant, New Energy Company of Indiana, produces ethanol at its plant in South Bend, Indiana. New Energy brought this action to enjoin the Tax Commissioner from implementing or enforcing R.C. 5735.145 on the grounds that it improperly burdened interstate commerce. New Energy claimed that since Indiana does not have a reciprocal ethanol tax credit, it does not benefit from the tax credit under R.C. 5735.145(B), and thus it cannot compete in the Ohio market. New Energy contended the statute discriminates against out-of-state producers, is an unreasonable burden on interstate commerce, and is an attempt at forced reciprocity.

Appellee South Point Ethanol, Ohio's only producer of ethanol, was granted leave to intervene. The trial court denied New Energy the relief it sought, and New Energy appealed to the court of appeals, which affirmed.

The cause is now before this court upon the allowance of a motion for rehearing.

*Murphey, Young & Smith Co., L.P.A., David J. Young, Kevin R. McDermott and Herman Schwartz*, for appellant.

*Anthony J. Celebrezze, Jr.*, attorney general, and *Richard C. Farrin*, for appellees Tax Commissioner and Treasurer of State.

*Jones, Day, Reavis & Pogue and David C. Crago*, for appellee South Point Ethanol.

*Patricia M. Wilson*, urging reversal for *amicus curiae*, Marathon Petroleum Co.

GREY, J. A state may enact valid legislation which promotes some local interest, and which affects interstate commerce within its borders, but it may not discriminate against interstate commerce or impose unreasonable restrictions on it. The problem in almost all of these kinds of cases is in deciding where to draw the line. In *Boston Stock Exchange v. State Tax Comm.* (1977), 429 U.S. 318, the United States Supreme Court in discussing the Commerce Clause stated, at 329:

"\* \* \* the Clause is a limit on state power. Defining that limit has been a continuing task of this Court."

Commerce Clause cases generally involve four types of cases and problems: those directly barring out-of-state goods; those favoring local business over out-of-state goods; those which have the practical effect of barring out-of-state goods; and those which force reciprocity on sister states.

Cases of an outright bar on out-of-state goods are rare, and inapplicable here since R.C. 5735.145 does not bar ethanol produced outside the state.

An issue is presented, however, on whether the statute favors in-state producers, *i.e.*, whether it is a form of economic protectionism. The Supreme Court has regularly and consistently struck down state laws which have as their purpose the protection of local economic interests. In *Baldwin v. G.A.F. Seelig, Inc.* (1935), 294 U.S. 511, New York enacted a statute which prohibited the sale of milk produced out of state unless it was sold there at the minimum price set by New York. Seelig, Inc. bought milk in Vermont at a lower price and shipped it to New York, but was threatened with prosecution for

violation of the New York statute. The United States Supreme Court struck down the statute, holding that its only purpose was to protect New York milk producers from out-of-state price competition.

In *Hunt v. Washington State Apple Advertising Comm.* (1977), 432 U.S. 333, a similar protectionist statute was voided. Washington had a system of inspecting and grading its apples, equivalent of, or superior to, the federal grades and standards. North Carolina enacted a law which prohibited the sale of apples in containers using the Washington grading system. Under the North Carolina statute apples could be identified only by the federal grade or standard. The clear intent of the statute was to protect North Carolina apple growers from the heavily advertised Washington apple logo, and its reputation for quality. Again, the Supreme Court struck down this attempt at economic protectionism.

R.C. 5735.145 is not protectionist in either its purpose or effect. The tax credit is available to all producers, those in-state and those in states outside Ohio which provide a reciprocal tax credit. To be sure, appellant New Energy is adversely affected by Ohio tax credit policy, but mere adverse effect on the business of one competitor is not sufficient to have a valid statute declared unconstitutional. *Minnesota v. Clover Leaf Creamery Co.* (1981), 449 U.S. 456, and *Exxon Corp. v. Governor of Maryland* (1978), 437 U.S. 117, are representative of the Supreme Court's decisions.

In *Exxon*, Maryland enacted a statute which prohibited a producer or refiner of petroleum products from also operating retail gas stations. The Maryland legislature felt that during the 1973 oil shortage the refiners favored the company-owned stations over independent retailers. Exxon sued claiming the statute was a burden on interstate companies who were being forced to divest themselves of their retail operations. The Supreme Court dis-

agreed, and pointed out that in-state independent dealers would have no competitive advantage over out-of-state dealers.

The court made the point succinctly:

"If the effect of a state regulation is to cause local goods to constitute a larger share, and goods with an out-of-state source to constitute a smaller share, of the total sales in the market—as in *Hunt*, 432 U.S., at 347, and *Dean Milk [v. Madison]* (1951), 340 U.S., at 354, the regulation may have a discriminatory effect on interstate commerce. But the Maryland statute has no impact on the relative proportions of local and out-of-state goods sold in Maryland and, indeed, no demonstrable effect whatsoever on the interstate flow of goods. The sales by independent retailers are just as much a part of the flow of interstate commerce as the sales made by the refiner-operated stations." *Id.* at 126, fn. 16.

In *Clover Leaf Creamery Co.*, the United States Supreme Court cited and followed *Exxon*, at 474:

"In *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117 (1978), we upheld a Maryland statute barring producers and refiners of petroleum products—all of which were out-of-state businesses—from retailing gasoline in the State. We stressed that the Commerce Clause 'protects the interstate market, not particularly interstate firms, from prohibitive or burdensome regulations.' *Id.*, at 127-128. A nondiscriminatory regulation serving substantial state purposes is not invalid simply because it causes some business to shift from a predominately out-of-state industry to a predominately in-state industry. Only if the burden on interstate commerce clearly outweighs the State's legitimate purpose does such a regulation violate the Commerce Clause."

In *Clover Leaf Creamery Co.* the state of Minnesota adopted a law banning the sale of milk in nonreturnable, nonrefillable plastic containers, i.e., the ubiquitous gallon

jug. The debate in the legislature centered around which container, plastic or paper, was the more environmentally sound. The Minnesota Supreme Court in holding the statute to be unconstitutional, found, “\* \* \* in effect, that the legislature misunderstood the facts.” *Id.* at 469.

This same point is raised by New Energy, and by *amicus* Marathon, *i.e.*, that Ohio’s ethanol tax credit program is not founded on a rational and legitimate state interest. Both conceded that removing lead from gasoline, and thus from the environment, is a desirable health goal, but urge that ethanol is not the only solution. This argument is put clearly by Marathon:

“Quite simply, it is Marathon’s position that if today no consensus has yet been reached within the industry as to the health aspects of ethanol, it is implausible to say that the Ohio legislature arrived at such a consensus when it enacted the general ethanol subsidization statute, R.C. 5735.145.”

We believe that Marathon and appellant make the same mistake that was made by the Minnesota Supreme Court. The United States Supreme Court noted, in *Clover Leaf Creamery Co.*, at 469:

“The Minnesota Supreme Court may be correct that the Act is not a sensible means of conserving energy. But we reiterate that ‘it is up to legislatures, not courts, to decide on the wisdom and utility of legislation.’ *Ferguson v. Skrupa*, 372 U.S. 726, 729 (1963).”

This court makes no decision on the wisdom of R.C. 5735.145, but we do find that its enactment is rationally related to a legitimate state interest. The statute is not “simply protectionism,” *Philadelphia v. New Jersey* (1978), 437 U.S. 617, and is not void on that ground.

A most recent case is *CTS Corp. v. Dynamics Corp. of America* (1987), 481 U.S. —, 95 L. Ed. 2d 67. In *CTS*, Indiana enacted a statute to protect the sharehold-

ers of Indiana corporations from hostile tender offers. While this case is not directly on point, it does demonstrate the United States Supreme Court’s consistent position on evenhandedness, at 84:

“Dynamics nevertheless contends that the statute is discriminatory because it will apply most often to out-of-state entities. This argument rests on the contention that, as a practical matter, most hostile tender offers are launched by offerors outside Indiana. But this argument avails Dynamics little. ‘The fact that the burden of a state regulation falls on some interstate companies does not, by itself, establish a claim of discrimination against interstate commerce.’ *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 126 \* \* \* (1978). See *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 471-472 \* \* \* (1981) (rejecting a claim of discrimination because the challenged statute ‘regulate[d] evenhandedly \* \* \* without regard to whether the [commerce came] from outside the State’); *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 619 \* \* \* (1981) (rejecting a claim of discrimination because the ‘tax burden [was] borne according to the amount \* \* \* consumed and not according to any distinction between in-state and out-of-state consumers’). Because nothing in the Indiana Act imposes a greater burden on out-of-state offerors than it does on similarly situated Indiana offerors, we reject the contention that the Act discriminates against interstate commerce.”

Using this same standard we find that R.C. 5735.145 is not protectionist and is not unreasonably burdensome on interstate commerce. It does not give an advantage solely to Ohio producers, and does not interfere with the flow of ethanol into Ohio by out-of-state suppliers.

This can best be shown by considering, hypothetically, what the result would be if Ohio had no ethanol producer. Producers in the states with a reciprocal tax credit pro-

gram would ship ethanol into Ohio and receive the statutory tax credit. Producers from states without a reciprocal program would, as appellant, still be at a disadvantage. There would be no burden on interstate commerce *per se*, but only on *some companies* in interstate commerce. This is not unconstitutional. *Exxon, supra*; *Clover Leaf Creamery Co., supra*.

Now let us hypothecate that an Ohio ethanol producer comes into the market. What would the status of that Ohio producer be vis-a-vis the other companies in the interstate ethanol business? The new Ohio company would receive the tax credit, and a reciprocal tax credit for its sales in other states. This new Ohio producer would be in a position identical to the other interstate reciprocal producers. Identity of treatment for in-state and out-of-state producers is the very essence of the Supreme Court's standard of "evenhandedness."

Simply put, R.C. 5735.145 is neither protectionist nor unreasonably burdensome on interstate commerce.

The issue of forced reciprocity, however, presents this court with a thorny problem. State statutes which are facially discriminatory must be subject to the "strictest scrutiny," *Hughes v. Oklahoma* (1979), 441 U.S. 322, and state statutes forcing reciprocal action by other states are also subject to that kind of scrutiny, *Sporhase v. Nebraska, ex rel. Douglas* (1982), 458 U.S. 941.

The problem with forced reciprocity is that inquiry must always begin by determining who is forcing whom. About thirty states allow tax credits for gasohol. Most of the states near Ohio have reciprocal tax credit programs, as did Indiana until recently when it adopted a direct subsidy program. New Energy, an Indiana producer located a mere one hundred miles from the Ohio market, now claims that Ohio's reciprocal tax feature is a burden on interstate commerce, and that it cannot compete in the Ohio market. If New Energy is successful

here, R.C. 5735.145(B) will be repealed. In that event, appellee South Foint will not be entitled to a tax credit across the Ohio River in Kentucky. South Point would then have a cause of action against Kentucky and its ethanol producers to enjoin them from granting a tax credit. The Kentucky producers would have a cause of action against neighboring states, and so on, until each state's reciprocal tax credit program would fall like a row of dominos.

There is no question that the sovereign state of Indiana has every right to switch from a reciprocal tax credit program to a direct producer subsidy program. If Indiana has determined that a subsidy program is more beneficial for that state, so be it. If because of this policy change an Indiana ethanol producer is put at a disadvantage in maintaining its share of the Ohio market, so be that, too. But a change in one state's policy, or a loss of a company's market share, is simply not a constitutional issue.

It should be remembered that the bulk of ethanol and gasohol sold in Ohio is obtained primarily through interstate commerce, whereby ethanol is shipped into Ohio from Illinois and Tennessee. Thus, New Energy's inability to compete in the Ohio market will not affect the flow of ethanol through interstate commerce into Ohio gas stations.

Contrast this situation with *Hughes, supra*, where Oklahoma banned the shipment of minnows out of state. It was a complete ban; Oklahoma minnows were not allowed entry into interstate commerce. The United States Supreme Court found that preserving wildlife is an important state concern, but noted that the statute did not limit the number of minnows caught but only their sale outside the state. This was described as a discriminatory alternative, most burdensome on interstate commerce. There is no outright ban on interstate commerce under

R.C. 5735.145. In practical effect, since Ohio's need for ethanol far exceeds the production capacity of its sole in-state producer, the reciprocal tax credit program encourages out-of-state producers to sell in Ohio. Interstate commerce is encouraged, and Ohio's interest in reducing lead pollution is promoted.

In *Sporhase, supra*, a landowner had property which straddled the Nebraska-Colorado state line. A well located on the Nebraska side was used to irrigate some of the Colorado land. Nebraska had a statute which prohibited the transport of ground water out of Nebraska into any state which did not reciprocally allow its water to be transported into Nebraska. Colorado had no such reciprocal statute.

The *Sporhase* decision begins by pointing out the important state interest in regulating ground water, particularly in the semi-arid western states, for conservation, equitable apportionment, and the health of the citizenry. The court found, however, that the Nebraska statute was a complete bar to interstate commerce, and not related to those legitimate state interests:

"The reciprocity requirement fails to clear this initial hurdle. For there is no evidence that this restriction is narrowly tailored to the conservation and preservation rationale. Even though the supply of water in a particular well may be abundant, or perhaps even excessive, and even though the most beneficial use of that water might be in another State, such water may not be shipped into a neighboring State that does not permit its water to be used in Nebraska." *Id.* at 957-958.

In a similar vein, in *Dean Milk Co. v. Madison* (1951), 340 U.S. 349, the United States Supreme Court struck down a complete bar to interstate commerce.

In *Great A & P Tea Co. v. Cottrell* (1976), 424 U.S. 366, the court followed the "practical effect" concept, *i.e.*,

although couched in the language of establishing sanitary standards, the Mississippi regulations had the effect of barring out-of-state milk. The court looked past the supposed health standards and found that the regulation was designed to bar milk, good milk or bad, from non-reciprocating states.

In short, in *Hughes, supra*, no minnows left Oklahoma. In *Sporhase*, no water was transported into Colorado. In *Great A & P Tea Co.*, no Louisiana milk entered Mississippi. We do not have that kind of situation here. There is no bar, direct or indirect, on interstate commerce.

We conclude by pointing out the specific relief sought by appellant here—a permanent injunction against the state of Ohio from implementing or enforcing R.C. 5735.145. Ohio has elected to promote the use of gasohol by granting a tax credit to Ohio producers of ethanol. Ohio has extended that tax credit to all interstate producers of ethanol who grant a tax credit to Ohio producers. The reciprocal tax credits promote the sale of Ohio ethanol outside the state, and encourage the shipment of ethanol into Ohio; yet, appellant would have us enjoin this as a burden on interstate commerce.

We iterate the maxim in *Exxon*—the Constitution protects commerce, not companies.

Accordingly, the judgment of the court of appeals is affirmed.

*Judgment affirmed.*

HOLMES, DOUGLAS and WRIGHT, JJ., concur.

SWEENEY, Acting C.J., LOCHER and H. BROWN, JJ., dissent.

SWEENEY, J., sitting for MOYER, C.J.

GREY, J., of the Fourth Appellate District, sitting for SWEENEY, J.

HERBERT R. BROWN, J., dissenting. I respectfully dissent. In my view, R.C. 5735.145(B) impermissibly discriminates against interstate commerce, as was properly recognized by this court on the first hearing of this case.

## I

Section 8, Article I of the Constitution of the United States provides that "[t]he Congress shall have Power \* \* \* to regulate Commerce with Foreign Nations, and among the several States \* \* \*." The United States Supreme Court has explained that "the Commerce Clause was not merely an authorization to Congress to enact laws for the protection and encouragement of commerce among the States, but by its own force created an area of trade free from interference by the States \* \* \* [T]he Commerce Clause even without implementing legislation by Congress is a limitation upon the power of the States." *Freeman v. Hewit* (1946), 329 U.S. 249, 252.

Although the power to lay taxes upon interstate commerce is reserved to the states, a state exercising this power must respect the national interest in free and open interstate trade. "No State, consistent with the Commerce Clause, may 'impose a tax which discriminates against interstate commerce \* \* \* by providing a direct commercial advantage to local business.'" *Boston Stock Exchange v. State Tax Comm.* (1977), 429 U.S. 318, 329 (quoting *Northwestern States Portland Cement Co. v. Minnesota* [1959], 358 U.S. 450, 458). "The Commerce Clause forbids discrimination, whether forthright or ingenious." *Best & Co., Inc. v. Maxwell* (1940), 311 U.S. 454, 455.

A legitimate legislative purpose does not save a discriminatory statute. As the Supreme Court has made clear: "'[W]hatever [a State's] ultimate purpose, it may not be accomplished by discriminating against articles of commerce coming from outside the State unless there is

some reason, apart from their origin, to treat them differently.'" *Hughes v. Oklahoma* (1979), 441 U.S. 322, 337, at fn. 17 (quoting *Philadelphia v. New Jersey* [1978], 437 U.S. 617, 626-627).

It is against this constitutional standard that R.C. 5735.145(B) must be measured, and against which it cannot be upheld.

## II

Ohio law requires motor vehicle fuel dealers to pay taxes on all motor vehicle fuel sold, used or distributed in Ohio. See R.C. 5735.05, 5735.25 and 5735.29. As originally enacted in 1981, R.C. 5735.145 granted a credit to dealers against such taxes with respect to fuel containing a blend of not more than ten percent by volume of ethanol, *without regard to where the ethanol was produced*. Effective January 1, 1985, however, the General Assembly amended R.C. 5735.145, adding subsection (B), which provides:

"The qualified fuel otherwise eligible for the qualified fuel credit shall not contain ethanol produced outside Ohio unless the tax commissioner determines that the fuel claimed to be eligible for credit contains ethanol produced in a state that also grants an exemption, credit or refund from such state's motor vehicle fuel excise tax or sales tax for similar fuel containing ethanol produced in Ohio; provided, however, that such credit shall not exceed the amount of the credit allowable for qualified fuel containing ethanol produced in Ohio." (Emphasis added.)

Thus, R.C. 5735.145(B) facially discriminates against interstate commerce. As the majority appears to concede, it also attempts to force other states to enact reciprocal legislation. Accordingly, as the majority recognizes, the statute is subject to the "strictest scrutiny." See *Sporhase v. Nebraska, ex rel. Douglas* (1982), 458 U.S. 941, 958; *Hughes v. Oklahoma, supra*, at 337. Nevertheless, the majority fails to strictly scrutinize R.C. 5735.145(B).

The majority's analysis is flawed in four separate respects.

### A

First, the majority errs in insisting that R.C. 5735.145 (B) regulates "evenhandedly," and in attempting to analogize the cause *sub judice* to *CTS Corp. v. Dynamics Corp. of America* (1987), 481 U.S. —, 95 L.Ed. 2d 67, *Minnesota v. Clover Leaf Creamery Co.* (1981), 449 U.S. 456, and *Exxon Corp. v. Governor of Maryland* (1978), 437 U.S. 117. The Ohio statute (R.C. 5735.145(B)) is decidedly distinguishable from the statutes at issue in those cases.

In *CTS*, the Indiana statute gave protection to Indiana corporations from *all* hostile tender offers; it made no distinction between tender offers coming from within the state and those coming from outside it. Likewise, in *Clover Leaf Creamery*, the statute at issue simply forbade the sale of milk in nonreturnable, nonrefillable plastic containers; nothing in the statute distinguished between containers made in Minnesota and containers made elsewhere. Finally, in *Exxon*, the Maryland statute prohibited *all* producers and refiners of petroleum products from also operating retail gas stations in Maryland; it drew no geographical lines separating those producers or refiners.

In stark contrast, R.C. 5735.145(B) contains an *explicit* distinction between ethanol produced in Ohio and ethanol produced in states not granting a reciprocal tax credit. R.C. 5735.145(B) is thus plainly discriminatory on its face. Repetitious assertion by the majority that R.C. 5735.145(B) regulates "evenhandedly" is no substitute for analysis of the law.

Certainly the majority cannot muster support for such assertions from *CTS*, *supra*. In that case, the United States Supreme Court explained, in a passage only partially quoted by the majority:

"The principal objects of dormant Commerce Clause scrutiny are statutes that discriminate against interstate commerce. \* \* \* The Indiana Act is not such a statute. *It has the same effects on tender offers whether or not the offeror is a domiciliary or resident of Indiana.* \* \* \*

"\* \* \* Because nothing in the Indiana Act imposes a greater burden on out-of-state offerors than it does on similarly situated Indiana offerors, we reject the contention that the Act discriminates against interstate commerce." (Emphasis added.) *Id.* at —, 95 L. Ed. 2d at 84.

Nor can the majority rely upon *Clover Leaf Creamery*, *supra*, wherein the Supreme Court emphasized:

"Minnesota's statute does not effect 'simple protectionism,' but 'regulates evenhandedly' by prohibiting all milk retailers from selling their products in plastic, non-returnable milk containers, *without regard to whether the milk, the containers, or the sellers are from outside the State. This statute is therefore unlike statutes discriminating against interstate commerce, which we have consistently struck down.*" (Emphasis added.) *Id.* at 471-472.

With all deference to the majority, R.C. 5735.145(B) is not a statute that imposes a burden upon businesses which, *coincidentally*, happen to be located outside Ohio. R.C. 5735.145(B) is a gun, aimed at businesses located outside Ohio.

### B

In its attempt to wish away the distinction between R.C. 57.35.145(B) and the statutes in *CTS*, *Clover Leaf Creamery* and *Exxon*, the majority seizes on the credit given to ethanol producers in states that do grant reciprocal tax credits. Referring to those producers, the majority boasts that R.C. 5735.145(B) "does not give an advantage *solely* to Ohio producers." (Emphasis added.)

The majority apparently believes that a statute which grants a commercial advantage to in-state businesses does not discriminate against interstate commerce unless the advantage is granted "solely" to the in-state businesses. Contrary to this belief, the constitutional infirmity of R.C. 5735.145(B) is *aggravated* by its forced reciprocity provision.

The majority's position is undermined by *Great A & P Tea Co. v. Cottrell* (1976), 424 U.S. 366. In *A & P*, the Mississippi regulation at issue permitted the importation of milk produced in another state *only if that state accepted milk produced in Mississippi on a reciprocal basis*. Thus, as with R.C. 5735.145(B), the regulation did not "solely" protect in-state businesses. Milk producers outside Mississippi were also protected if their state allowed the importation of milk from Mississippi. Nevertheless, the United States Supreme Court struck down the mandatory reciprocity provision because upholding it would "invite a multiplication of preferential trade areas destructive of the very purpose of the Commerce Clause." *Id.* at 380 (quoting *Dean Milk Co. v. Madison* [1951], 340 U.S. 349, 356).<sup>2</sup>

The majority acknowledges that the forced reciprocity provision in R.C. 5735.145(B) is a "thorny problem," but rationalizes it away on the premise that a decision favorable to appellant would cause other states' reciprocal tax credit programs to "fall like a row of dominos." However, the United States Supreme Court has emphasized that the tax laws of other states are irrelevant to a determination of whether a particular state's statute violates the Commerce Clause. See *Tyler Pipe Industries*,

<sup>2</sup> See, also, *Best & Co., Inc. v. Maxwell*, *supra*, wherein the United States Supreme Court held unconstitutional a North Carolina privilege tax imposed upon businesses which displayed merchandise for sale in that state but which were not "regular retail merchants" therein. As with R.C. 5735.145(B), the invalid North Carolina tax favored all in-state sellers and *some* out-of-state sellers.

*Inc. v. Washington Dept. of Revenue* (1978), 483 U.S. —, —, 97 L. Ed. 2d 199, 210, wherein the court proclaimed, as to the tax therein at issue:

"The facial unconstitutionality of Washington's gross receipts tax cannot be alleviated by examining the effect of legislation enacted by its sister States."

The Supreme Court in *Tyler Pipe Industries* emphasized: "The immunities implicit in the Commerce Clause and the potential taxing power of a State can hardly be made to depend on the shifting incidence of the varying tax laws of the various States at a particular moment." *Id.* at —, 97 L. Ed. 2d at 210, fn. 11 (quoting *Freeman v. Hewit*, *supra*, at 256, and *Armco Inc. v. Hardesty* [1984], 467 U.S. 638, 645, at fn. 8).

Therefore, the majority's attempt to escape from the facial discrimination of R.C. 5735.145(B) lands it squarely within the briar patch of forced reciprocity.

### C

In its claim that R.C. 5735.145(B) is constitutional because it does not effect a *complete ban* upon the importation of ethanol from non-reciprocating states, the majority errs again. Even if it is assumed that the practical effect of a competitive disadvantage of twenty-five cents per gallon of ethanol is not tantamount to a complete ban, the majority's claim nonetheless fails because it rests upon the false premise that a complete ban is necessary to constitute a Commerce Clause violation.

In numerous cases, the United States Supreme Court has invalidated discriminatory state taxes without requiring that they be so drastic as to erect an impenetrable barricade to commerce at the state border. See, *e.g.*, *Tyler Pipe Industries*, *supra*; *Bacchus Imports, Ltd. v. Dias* (1984), 468 U.S. 263; *Armco*, *supra*; *Maryland v.*

*Louisiana* (1981), 451 U.S. 725; *Boston Stock Exchange, supra*.<sup>3</sup>

Indeed, the law on discriminatory state taxes has been established for at least a century. In *Walling v. Michigan* (1886), 116 U.S. 446, 455, the court declared:

"A discriminatory tax imposed by a State operating to the disadvantage of the products of other States when introduced into the first mentioned State, is, in effect, a regulation in restraint of commerce among the States, and as such is a usurpation of the power conferred by the Constitution upon the Congress of the United States."<sup>4</sup>

Thus, the alleged absence of a complete ban upon the importation of ethanol by R.C. 5735.145(B) does not save this statute.

### III

The majority makes its fourth and final error when it suggests that this court, if it finds R.C. 5735.145(B) unconstitutional, must then invalidate *all* of R.C. 5735.145. There is no merit in this suggestion. This court could, and should, hold that R.C. 5735.145(B) *alone* is invalid. The result of such holding would be that the tax credit of R.C. 5735.145 would be available to dealers with respect to *all* ethanol sold, used, or distributed in Ohio—not just for ethanol which originates in Ohio or

<sup>3</sup> State regulations, as opposed to taxes, also need not affect a total ban upon importation to impermissibly burden or discriminate against interstate commerce. See *Hunt v. Washington State Apple Advertising Comm.* (1977), 432 U.S. 333, wherein the court invalidated a facially neutral North Carolina statute requiring closed containers of out-of-state apples to bear no quality grade markings showing other than the applicable federal grade. Such regulation plainly did not completely ban the importation of out-of-state apples, but it did put their growers at a competitive disadvantage.

<sup>4</sup> This passage was recently quoted with approval in *Bucchus Imports, supra*, at 271.

in a state which grants reciprocal tax credits to Ohio producers. That result, unlike the one reached by the majority, would accomplish the evenhanded treatment mandated by the Commerce Clause.

The United States Supreme Court recently emphasized in *Tyler Pipe Industries, supra*: "The conclusion is inescapable: equal treatment for in-state and out-of-state taxpayers similarly situated is the condition precedent for a valid use tax on goods imported from out-of-state," *Id.* at —, 97 L. Ed. 2d at 213 (quoting *Halliburton Oil Well Cementing Co. v. Reily* [1963], 373 U.S. 64, 70). Because R.C. 5735.145(B) fails to satisfy that condition precedent, I must respectfully dissent.

SWEENEY, Acting C.J., and LOCHER, J., concur in the foregoing dissenting opinion.

No. 86-784

NEW ENERGY COMPANY OF INDIANA,  
*Appellant,*  
 v.  
 LIMBACH, Tax Commr., *et al.*,  
*Appellees.*

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 File No. 5129
 

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BROWN, CLIFFORD, J.

[Cite as New Energy Co. v. Limbach (1986), Ohio St. 3d.]

R.C. 5735.145(B) discriminates against interstate commerce in violation of the Commerce Clause of the United States Constitution. (Clause 3, Section 8 of Article I).

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(No. 86-784—Decided December 26, 1986.)

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APPEAL from the Court of Appeals for Franklin County.

Plaintiff-appellant, New Energy Company of Indiana, manufactures ethanol and is engaged in commerce among the states. Ethanol is a 199 proof alcohol which is mixed with gasoline in a 10/90 ratio to form a blend called gasohol. Plaintiff's manufacturing facility is located in South Bend, Indiana. Ethanol produced by New Energy has been marketed in Ohio at a rate of approximately one million gallons per month.

Effective January 1, 1985 the Ohio General Assembly amended R.C. 5735.145(B) to provide that any fuel otherwise eligible for a tax credit shall not contain ethanol produced outside Ohio unless the state of origin provides a similar tax credit, exemption or refund for similar fuel containing ethanol produced in Ohio. Indiana does not provide any such credit, exemption or refund for Ohio-produced ethanol.

Plaintiff brought this action to challenge the constitutionality of R.C. 5735.145(B), seeking declaratory and injunctive relief. Plaintiff contended, *inter alia*, that the statute violates the Commerce Clause of the United States Constitution by placing an undue burden on interstate commerce. Plaintiff alleged that the statute effectively barred it from marketing its ethanol in Ohio, since the unavailability of a tax credit for plaintiff's ethanol renders the product economically undesirable to Ohio dealers.

The trial court held that R.C. 5735.149(B) is constitutional, finding no significant burden on interstate commerce.

The court of appeals affirmed. In holding that the statute does not violate the Commerce Clause, the court reasoned that it has neither a discriminatory purpose nor a discriminatory effect. It gives no benefit to Ohio ethanol producers that is not equally available to an out-of-state producer as long as that state provides incentives to all ethanol producers, including Ohio, on an equal basis. The court stressed that the statute effectuates the legitimate state purpose of encouraging the production of an environmentally benign fuel additive as a replacement for lead, a notorious pollutant. The statute does not constitute an outright ban on plaintiff's ethanol in Ohio, nor does it preclude plaintiff from doing business in Ohio. It gives no direct competitive advantage to Ohio

producers. It does not tax the use or sale of ethanol differently depending on whether it was produced in or out of Ohio. In sum, the statute does not impermissibly impose an oppressive burden on the industry and business of other states in order to enhance the vitality of domestic commerce.

The cause is now before this court pursuant to the allowance of a motion to certify the record.

*Murphy, Young, & Smith, David J. Young, Kevin R. McDermott and Herman Schwartz, for appellant.*

*Anthony J. Celebrezze Jr., attorney general, and Richard C. Farrin, for appellees Tax Commissioner and Treasurer of State.*

*Jones, Day, Reaves & Pogue and David C. Crago, for appellee South Point Ethanol.*

CLIFFORD F. BROWN, J. The chief question posed by this appeal is whether R.C. 5735.145(B) places an undue burden on interstate commerce in violation of the Commerce Clause of the United States Constitution. For the following reasons, we hold that it does, and that the statute is therefore unconstitutional.

R.C. 5735.05, 5735.25 and 5735.29 require motor vehicle fuel dealers to pay taxes on all motor vehicle fuel sold, used, or distributed in Ohio, including gasoline containing ethanol. As originally enacted in 1981, R.C. 5735.145 granted dealers a credit against such tax with respect to the sale, use or distribution of gasoline containing not more than ten percent by volume of ethanol. Effective January 1, 1985, the legislature amended the statute, adding subdivision (B), which is the subject of this appeal. It provides as follows:

"The qualified fuel otherwise eligible for the qualified fuel credit shall not contain ethanol produced outside Ohio unless the tax commissioner determines that the

fuel claimed to be eligible for credit contains ethanol produced in a state that also grants an exemption, credit or refund from such state's motor vehicle fuel excise tax or sales tax for similar fuel containing ethanol produced in Ohio; provided, however, that such credit shall not exceed the amount of the credit allowable for qualified fuel containing ethanol produced in Ohio."

Appellant argues that this provision violates the Commerce Clause of the United States Constitution. It contends that the statute places an impermissible burden on interstate commerce by discriminating against ethanol produced outside of Ohio. Appellant submits that the court of appeals overlooked the practical impact of the statute, which is to bar from the Ohio market any producer from a state which does not have a reciprocal tax scheme. It gives a direct commercial advantage to local production at the expense of out-of-state manufacturers. The fact that the statute is not an outright ban on appellant's ethanol is irrelevant where that is its practical effect, since the statute makes it economically unfeasible for Ohio dealers to buy appellant's product.

We find this reasoning to be compelling. For the reasons that follows, we agree that R.C. 5735.145(B) is unconstitutional as an undue burden on interstate commerce.

The Constitution of the United States provides that "[t]he Congress shall have power \* \* \* [t]o regulate commerce with foreign nations and among the several States \* \* \*." Clause 3, Section 8 of Article I. The United States Supreme Court has held that "the Commerce Clause was not merely an authorization to Congress to enact laws for the protection and encouragement of commerce among the States, but by its own force created an area of trade free from interference by the States. \* \* \* [T]he Commerce Clause even without im-

plementing legislation by Congress is a limitation upon the power of the States." *Freeman v. Hewit* (1946), 329 U.S. 249, 252. The states still reserve the power to impose taxes as a source of state revenue, but in exercising this power, the states must respect the national interest in free and open interstate trade. *Boston Stock Exch. v. State Tax Comm.* (1977), 429 U.S. 318, 329. This balancing of the state's interest in its indispensable power of taxation and the national need for an unrestrained interstate market has necessitated a case-by-case approach in this area, such that the result "turns on the unique characteristics of the statute at issue and the particular circumstances in each case." *Id.* at 329. A fundamental principle is that no state may impose a tax which discriminates against interstate commerce by presenting local business with a direct commercial advantage. *Memphis Steam Laundry Cleaner, Inc. v. Stone* (1952), 342 U.S. 389. State legislation which has the practical effect of barring out-of-state business while leaving domestic business unaffected discriminates against interstate commerce by insulating in-state industry from the effects of out-of-state competition. *Hunt v. Wash. State Apple Adv. Comm.* (1977), 432 U.S. 333.

In formulating our analysis of whether R.C. 5735.145 (B) impermissibly burdens interstate commerce, we must remain mindful of the importance of Ohio's power of taxation and the legitimate purpose, if any, of the statute at issue. *Boston Stock Exch., supra.* We are aware of the benefits of ethanol as a cost-effective replacement for lead in gasoline. Lead is a proven atmospheric pollutant, while ethanol is considered an environmentally benign additive. We are fully cognizant that encouraging the use of ethanol as a substitute for lead in gasoline is a legitimate goal of state government as a means of promoting the health of its citizens. However, a finding that

the statute furthers matters of legitimate local concern does not end the inquiry. The local concern must be weighed against the competing national interest in unhindered interstate trade. *Hunt, supra*, at 350. Upon weighing the goal as effectuated by R.C. 5735.145(B) against the burden it imposes on interstate commerce, we find that the burden is excessively oppressive and therefore constitutionally unacceptable.

"The commerce clause forbids discrimination, whether forthright or ingenious." *Best & Co. v. Maxwell* (1940), 311 U.S. 454, 455; *Dayton Power & Light Co. v. Lindley*, (1979), 58 Ohio St. 2d 465, 468. The United States Supreme Court has framed the general rule for determining the validity of state statutes affecting interstate commerce as follows: "Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits." *Pike v. Bruce Church, Inc.* (1970), 397 U.S. 137, 142.

Thus, the statute must regulate "even-handedly" in order to clear even the first hurdle of a Commerce Clause inquiry. This essential attribute of even-handed treatment is not present in R.C. 5735.145(B). The statute makes a distinction based on the origin of the ethanol, a distinction which favors all Ohio ethanol producers but only some out-of-state producers. This cannot be countenanced. It is unavailing that the statute unduly burdens only some, rather than all, out-of-state producers. The United States Supreme Court has stricken a North Carolina annual privilege tax levied against every person or corporation, not a regular retail merchant in the state, who displayed samples in any hotel room rented or occupied temporarily for the purpose of securing retail orders. *Best & Co., supra.* The statute was invalidated even though the court recognized that some out-of-state

businesses may be "regular retail merchants" (*ibid.* at 456) in North Carolina and thus would be unaffected. The court reasoned that the statute, in its practical operation, creates an atmosphere hostile to interstate commerce and discourages the participation of competitors in the intrastate market. *Id.* at 456-457. Thus, the fact that a statute burdens only some, rather than all, out-of-state competition will not save an otherwise invalid state law.

We believe that the instant cause is similar in several respects to *Hunt*, *supra*. In *Hunt*, the United States Supreme Court struck down a North Carolina statute which prevented containers of apples shipped into that state from reflecting state quality grades. The court found that the challenged statute had the practical effect of not only burdening interstate sales of apples from Washington state, which displayed the Washington state variety and grade label, but also discriminating against them. *Id.* at 350. The barring of grade levels had the result of increasing the cost of doing business in North Carolina for Washington apple growers and dealers while leaving their North Carolina counterparts unaffected. *Id.* at 351.

The same effect is apparent in the case *sub judice*. The statute herein makes it more difficult, if not impossible, for appellant to sell its product in Ohio, while Ohio producers remain as free to market their wares as they were prior to the statute's enactment. The overall effect is to shield Ohio producers from competition from Indiana or any other state that does not give Ohio ethanol a tax credit similar to Ohio's. This discrimination against sales of a product according to its point of origin and the resultant burden imposed on free and open trade is constitutionally unacceptable. See, also, *Pike*, *supra*.

Where a discriminatory effect against interstate commerce is established, the state bears the burden of jus-

tifying it by showing both the local necessity for the statute and the unavailability of nondiscriminatory alternatives to further the same local interest. *Dean Milk Co. v. Madison* (1951), 340 U.S. 349, 354; *Hunt*, *supra*, at 353. In our view, appellees have not sustained this burden. The purported purpose of R.C. 5735.145(B) is to encourage the use of ethanol in Ohio gasoline through the allowance of a tax credit. But the ethanol produced in a state without a reciprocal tax scheme, which is not eligible for the credit, is no less desirable from a public health standpoint than ethanol produced in a reciprocating state. Nor have the appellee demonstrated the unavailability of a nondiscriminatory alternative to this scheme. The allowance of a tax credit for qualified fuel containing ethanol without regard for the ethanol's point of origin would have the same effect of encouraging the use of this additive without the discriminatory aspect of the present scheme. Appellees' argument that the reciprocity clause will prompt states surrounding Ohio to enact similar tax credit schemes to encourage ethanol use, thereby decreasing the polluting effect of neighboring atmospheres on Ohio's, is unpersuasive. The connection between the statute and this purported effect is too tenuous to justify the extreme burden on the free flow of interstate commerce.

The constitutional infirmity of R.C. 5735.145(B) is actually aggravated by this additional feature of forced reciprocity. The statute precludes any claim for a tax credit for fuel containing ethanol produced outside Ohio *unless* the ethanol was "produced in a state that also grants an exemption, credit or refund \* \* \* for similar fuel containing ethanol produced in Ohio." Thus, in order for ethanol produced out of state to qualify for the Ohio credit, the foreign state must provide Ohio ethanol with a similar credit. This "forced reciprocity" is violative of the Commerce Clause. In *Great A & P Tea Co., Inc. v. Cottrell* (1976), 424 U.S. 366, the United States

Supreme Court invalidated a Mississippi regulation which provided that milk and milk products from another state may be sold in Mississippi only if the other state accepts milk or milk products produced and processed in Mississippi on a reciprocal basis. The court held that a state may not, consistent with the Commerce Clause, "use the threat of economic isolation as a weapon to force sister States to enter into even a desirable reciprocity agreement." *Id.* at 379. The practical effect of such forced reciprocity provisions is to ban from the intrastate market any competitor from a state which does not obey the command to reciprocate. This effect of suppressing competition is constitutionally intolerable. See, also, *Baldwin v. G.A.F. Seelig, Inc.* (1935), 294 U.S. 511; *Sporhase v. Nebraska* (1982), 458 U.S. 941.

Accordingly, we hold that R.C. 5735.145(B) discriminates against interstate commerce in violation of the Commerce Clause of the United States Constitution (Clause 3, Section 8 of Article I). The judgment of the court of appeals is therefore reversed.

*Judgment reversed.*

CELEBREZZ, C.J., SWEENEY and LOCHER, JJ., concur.

HOLMES, DOUGLAS and WRIGHT, JJ., dissent.

No. 86-784

NEW ENERGY CO.

v.

LIMBACH

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File No. 5129

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HOLMES, J., dissenting. Because I do not feel that R.C. 5735.145(B) imposes an unreasonable restraint or undue burden on interstate commerce, I must dissent from the majority's analysis and conclusion.

Ethanol producers in states which do not offer the reciprocal tax abatement to Ohio producers are quite able, even after the amendment of the Motor Vehicle Fuel Tax Act, to offer their product in Ohio ethanol markets—they simply are at a disadvantage price-wise vis-a-vis producers which offer ethanol that will procure a tax advantage for their Ohio consumers. Simply because New Energy Company of Indiana's proportion of the Ohio ethanol sales market may decrease because its profits will be substantially reduced does not necessarily establish a claim of unconstitutional discrimination against interstate commerce. See *Exxon Corp. v. Governor of Maryland* (1978), 437 U.S. 117, 126. The Commerce Clause has been held to protect " \* \* \* the interstate market, not particular interstate firms, from prohibitive or burdensome regulations." *Minnesota v. Clover Leaf Creamery Co.* (1981), 449 U.S. 456, 474, rehearing denied (1981) 450 U.S. 1027.

According to appellees Tax Commissioner *et al.*, at least thirty states, in addition to Ohio, have reciprocal

ethanol tax incentive statutes like the one in question here. It is undisputed that R.C. 5735.145(B) will not affect these other states' sales of ethanol in Ohio and their participation in interstate commerce. A statute does not impose an unconstitutional burden on interstate commerce simply because it, like the one in issue, merely " \* \* \* causes some business to shift from one interstate supplier to another." *Exxon Corp., supra*, at 127.

When state regulations contain a direct and unequal prohibition against out-of-state distribution, such may be a discriminatory burden on interstate commerce, *Hunt v. Washington State Apple Advertising Co.* (1977), 432 U.S. 333; *Memphis Steam Laundry Cleaner, Inc. v. Stone* (1952), 342 U.S. 389, and in those instances "only state interests of substantial importance" will save a statute, *Great A & P Tea Co., Inc. v. Cottrell* (1976), 424 U.S. 366, 375. However, in more complex situations such as the case *sub judice* in which there is no ban on interstate commerce, and where the statute regulates "a legitimate local public interest, and its effects on interstate commerce are only incidental, \* \* \* [the regulation] will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. [Citation omitted.] If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.'" *Great A & P Tea Co., supra*, at 371-372. See, also, *Pike v. Bruce Church, Inc.* (1970), 397 U.S. 137, 142. Thus, the result in each Commerce Clause challenge involving state taxing powers " \* \* \* turns on the unique characteristics of the statute at issue and the particular circumstances in each case." *Boston Stock Exch. v. State Tax Comm.* (1977), 429 U.S. 318, 329.

As the majority concedes, encouraging the use of ethanol as a substitute for lead in gasoline is a legitimate, if not compelling, goal of the state as a means of promoting the health of its citizens. It must also be understood that the practical effect of R.C. 5735.145(B) is not to bar the sale of appellant's corn product, but is to make the cost of appellant's ethanol more expensive to Ohio consumers vis-a-vis ethanol from some thirty-one other states. Since appellant failed to put forth any evidence that this would cause any major shifts in the interstate versus intrastate producers' proportions of the Ohio ethanol market, these effects are purely incidental to the state's attempt to reduce the amount of lead being emitted into the atmosphere. Additionally, this statute cannot be said to be excessively broad in relation to this state interest. The record establishes that, because of the high cost of producing ethanol, the market in which appellant competes would not even exist without federal and state tax incentives to gasoline dealers. Thus, the best, or perhaps only, way to achieve the state's goal of ethanol use is through its tax incentive program.

Having satisfied the basic requirements of the *Great A & P Tea Co., supra*, test, the question then becomes whether the state's interest in reducing lead pollutants outweighs the burden the state law could impose on interstate commerce. See, also, *Metropolitan Life Ins. Co. v. Ward* (1985), — U.S. —, 84 L.Ed. 2d 751, 760. Under our constitutional system, " \* \* \* the States retain 'broad power' to legislate protection for their citizens in matters of local concern such as public health, \* \* \* [citation omitted] and \* \* \* not every exercise of local power is invalid merely because it affects in some way the flow of commerce between the States." *Great A & P Tea Co., supra*, at 371; see, also, *Pike, supra*, at 143, where the court stated that the propriety of local legislation in the field of health and safety has long been recognized. Given these broad standards for reviewing

Commerce Clause challenges, I would find that the incidental burden on interstate commerce which may be caused by R.C. 5735.145(B) is outweighed by the state's interest in alleviating air pollution in this state, and in encouraging voluntary reciprocal provisions in other states does affect Ohio citizens).

This court has held "that in the absence of a showing that a statute is unconstitutional beyond a reasonable doubt, it will be upheld." *State, ex rel. Swetland, v. Kinney* (1980), 62 Ohio St. 2d 23, 30. Appellant bears a heavy burden to overcome the presumption of constitutionality of the statute, i.e., "'\* \* \* to negative every conceivable basis which might support it.'" *Dayton v. Cloud* (1972), 30 Ohio St. 2d 295, 300, quoting *Madden v. Kentucky* (1940), 309 U.S. 83, 88. There is no evidence that the instant statute was passed solely for the purpose or effect of protecting or giving commercial advantage to the one local manufacturer of ethanol at the expense of interstate commerce. In fact, the evidence shows that Ohio's one manufacturer is not equipped to fill any void in the Ohio market which might be caused by R.C. 5735.145(B). The fact that the provision may cause a shift in the Ohio market among out-of-state producers does not cause a discrimination against interstate commerce. *Clover Leaf Creamery Co., supra*, at 473; *Exxon, supra*, at 127.

Even if this tax statute were for the purpose of encouraging local industry, or for protecting local manufacturers from other states' tax schemes which discriminate against ethanol produced in any other state, such are permissible purposes, so long as it does not "\* \* \* impose a discriminating burden upon the business of other States merely to protect and promote local business." *Metropolitan Life Ins. Co., supra*, at 759, fn. 6. (Emphasis added.) Appellant clearly did not prove a discriminatory burden merely to protect and promote Ohio's ethanol business under the standard set forth in

*Kinney, supra*. Appellant not only failed to put forth any evidence that interstate commerce is or will be injured, but it also failed to show that local protection or promotion was the tax statute's sole purpose. See *Baldwin v. G.A.F. Seelig* (1935), 294 U.S. 511, 524, where the court struck down a statute which it recognized as having the sole purpose of economic protectionism.

Appellant cannot satisfy these tests beyond a reasonable doubt because R.C. 5735.145(B) allows tax credits on ethanol produced and imported from outside Ohio, and because the statute has the obvious purposes (1) of affording incentives for the use of ethanol in gasoline and (2) of encouraging other states to afford similar incentives. Not only is there no ban and no protectionism involved here, but the Ohio tax law actually encourages the purchase of ethanol produced in other states having similar incentive programs. Thus, this case is different from the decision in *Great A & P Tea Co., supra*, in which totally banned the importation of Louisiana milk into Mississippi because such law had a "devastating effect upon the free flow of interstate milk," *id.* at 375, and also is different from *Sporhase v. Nebraska* (1982), 458 U.S. 941, 957, in which the court struck down a reciprocal statute because it "operates as an explicit barrier to commerce."

Because R.C. 5735.145(B) does not protect Ohio's ethanol producer from competition from out-of-state ethanol producers, it is different from those statutes in all the relied-upon cases which have been struck down for interfering with interstate commerce. *Bacchus Imports, Ltd. v. Dias* (1984), 468 U.S. 263; *Armco, Inc. v. Hardesty* (1984), 467 U.S. 638; *National Meat Assn. v. Deukmejian* (C.A. 9, 1984), 743 F.2d 656, affirmed without opinion (Jan. 7, 1985), — U.S. —, 83 L.Ed.2d 766; *Boston Stock Exch., supra*, *Dayton Power & Light Co. v. Lindley* (1979), 58 Ohio St. 2d 465; *American Modulares v. Lindley* (1978), 54 Ohio St. 2d 273; *Phila-*

*delphia v. New Jersey* (1978), 437 U.S. 617; and *Great A & P Tea Co.*, *supra*.

The case *sub judice* is more like *Henneford v. Silas Mason Co.* (1937), 300 U.S. 577, than it is like the above cases. The *Henneford* court upheld a state statute which exempted out-of-state sales from the state use tax if a use or other state tax of similar amount had already been paid in the state of purchase. Since that tax scheme, which merely looked to the out-of-state tax treatment before in-state taxes were determined, was held to be non-discriminatory, so too should Ohio's abatement system which merely looks to the ethanol tax abatement treatment in the state of production.

Accordingly, I would affirm the judgment of the court of appeals.

Douglas and Wright, JJ., concur in the foregoing dissenting opinion.

IN THE COURT OF APPEALS OF OHIO  
TENTH APPELLATE DISTRICT

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No. 85AP-340

(REGULAR CALENDAR)

NEW ENERGY COMPANY OF INDIANA,  
*Plaintiff-Appellant,*  
v.

JOANNE LIMBACH *et al.*,  
*Defendants-Appellees.*

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OPINION

Rendered on May 8, 1986

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MESSRS. MURPHEY, YOUNG & SMITH, MR. DAVID J. YOUNG, MR. KEVIN R. McDERMOTT and R. JOHN K. LINES; MR. HERMAN SCHWARZ, for appellant.

MR. ANTHONY J. CELEBREZZE, JR., Attorney General, and MR. RICHARD C. FARRIN, for appellees Joanne Limbach, Tax Commissioner, and Mary Ellen Withrow, Treasurer, State of Ohio.

MESSRS. JONES, DAY, REAVIS & POGUE, MR. DAVID C. CRAGO, MR. JAMES R. KING and MS. GAIL E. GRIFFITH, for appellee South Point Ethanol.

APPEAL from the Franklin County Court of Common Pleas.

## WHITESIDE, J.

Plaintiff, New Energy Company of Indiana, appeals from a judgment of the Court of Common Pleas of Franklin County and has asserted the following as assignments of error:

"1. State tax laws which discriminate on the basis of out-of-state origin place an impermissible burden on interstate commerce and violate the Commerce Clause of the U.S. Constitution.

"2. A legislative purpose of 'affecting the policies of other states' by an insistence on reciprocity is not a legitimate purpose under the Commerce Clause and does not legitimate tax laws which discriminate against out-of-state manufacturers or producers.

"3. Commerce Clause violations do not require an absolute *ban* on doing business in the state which affects all interstate competitors.

"4. Once the United States Supreme Court has declared specific categories of legislation to be invalid under the Commerce Clause, a state statute within that category cannot be saved by a state presumption in favor of constitutional validity."

Defendant, South Point Ethanol, although it filed no notice of appeal, has raised the following cross-assignment of error:

"The trial court erred in finding that the appellant has standing to challenge the constitutionality of Ohio Rev. Code § 5735.145(B)."

Plaintiff brought this action challenging the constitutionality of the 1984 amendment to R.C. 5735.145(B), seeking declaratory and injunctive relief and naming defendants State Tax Commissioner and State Treasurer as defendants. Subsequently, defendant, South Point Ethanol, an Ohio producer of ethanol, was granted leave to intervene as a party-defendant.

R.C. 5735.05, 5735.25 and 5735.29 impose upon motor vehicle fuel dealers taxes with respect to all motor vehicle fuel, including gasoline containing ethanol sold, used, or distributed in Ohio. R.C. 5735.145, originally effective in 1981, grants motor vehicle fuel dealers a credit against such tax with respect to the sale, use or distribution of gasoline containing not more than ten percent by volume of ethanol. In 1984, R.C. 5735.145 was amended extensively, effective January 1, 1985, including the addition of R.C. 5735.145(B), which is the subject of this action and reads as follows:

"(B) The qualified fuel otherwise eligible for the qualified fuel credit shall not contain ethanol produced outside Ohio unless the tax commissioner determines that the fuel claimed to be eligible for credit contains ethanol produced in a state that also grants an exemption, credit or refund from such state's motor vehicle fuel excise tax or sales tax for similar fuel containing ethanol produced in Ohio; provided however, that such credit shall not exceed the amount of the credit allowable for qualified fuel containing ethanol produced in Ohio."

Prior to the amendment, the credit was thirty-five cents per gallon, but a statutory formula for calculation of the credit was adopted by the amendment, one of the purposes of which was to reduce the credit coincidental with an increase in the federal gasohol tax exemption.

The common pleas court correctly held that R.C. 5735.145(B) is constitutionally enforceable since plaintiff has demonstrated no violation of the Privileges and Immunities, the Equal Protection or Commerce Clauses of the United States Constitution, as contended.

At the outset, it must be noted that plaintiff has failed to set forth assignments of error in the manner required by the Appellate Rules. Not only are the assignments of error not separately stated *after* the table of contents

[App. R. 16(A)(2)], but what are labelled assignments of error are mere abstract statements of legal principles urged by plaintiff without any relationship to any error of law or fact the trial court is claimed to have committed. Nevertheless, we shall attempt to consider each as if it did raise an issue of some error on the part of the trial court. However, all of plaintiff's statements of contended law refer to the Commerce Clause, so that no issue is raised herein with respect to the Privileges and Immunities or Equal Protection Clauses. Thus, even assuming that plaintiff has a valid argument that the statute denies it equal protection of the law, that issue is not before us. Rather, the sole issue is whether the statute places an undue burden upon interstate commerce.

The parties filed a nonexclusive agreed statement of facts in the trial court, which includes the following:

"1. The plaintiff, New Energy Company of Indiana ('New Energy'), is an Indiana limited partnership engaged in Commerce among the states in the business of manufacturing ethanol. The plaintiff's manufacturing facility is located in South Bend, Indiana (Tr. 5). The plaintiff is the only ethanol manufacturer with production facilities in Indiana. Ethanol produced by New Energy is presently sold to blenders in several states including Ohio, Indiana and Illinois. (Plaintiff's Exs. 1 and 2)

.. . .

"5. South Point Ethanol ('South Point') intervened in this action as a defendant on March 27, 1985. South Point is a joint venture between Ashland Oil Company, the Ohio Farm Bureau, UGI and Publicker Industries which produces ethanol in Lawrence County, Ohio.

"6. South Point was formed in 1981 to retrofit a closed chemical plant. Its facility is located in South Point, Ohio. The joint venturers have invested ap-

proximately \$120,000,000 in South Point. Additionally, South Point provides approximately 185 jobs and expends \$100,000,000 annually in the production of ethanol from corn.

.. . .

"9. Ethanol is a 199 proof alcohol. It is derived from corn which is treated with enzymes that convert the starch to sugar and ultimately into alcohol. Ethanol is mixed with gasoline in a 10/90% ratio to form a blend commonly referred to as gasohol (Tr. 14).

"10. Ethanol is beneficial as a fuel additive to increase the octane rating of gasoline without contributing any additional lead into the environment. Ethanol is, in fact, the cost effective replacement for lead in gasoline and is the most environmentally benign replacement for lead. The production of ethanol also provides an outlet for the sale of corn surpluses (Tr. 9).

"11. Various governmental bodies have initiated programs to encourage the production of ethanol. The United States Department of Energy provides grants for feasibility studies and guarantees 90% of certain qualifying loans (Tr. 9). To encourage the use of ethanol, the Department of Treasury exempts ethanol/gasoline blends from 6c of the 9c federal excise tax on gasoline (Tr. 9). In addition, at least thirty-two states allow credits from their respective motor fuel taxes for ethanol/gasoline blends (Tr. 10). The provision of tax credits has been the best method adopted by the federal and state government to encourage the use of ethanol.

.. . .

"19. The amount of state tax credit available to dealers of ethanol on a gallon of ethanol directly affects the per gallon price that dealers pay to

ethanol producers in that the lower the available credit, the lower the price paid to ethanol producers for a gallon of ethanol (Tr. 28-29).

"20. The continued enforcement of R.C. § 5735.145 (B) will cause financial hardship to plaintiff."

In finding no Commerce Clause violation, the trial court stated in part:

"This Court has previously held that the purpose of the legislation in enacting *Rev. Code 5735.145(B)* was legitimate. The Court has further held that the plaintiff will receive a economic hardship as a result of the legislation; however, this Court has not found that the legislation will impose a significant burden on interstate commerce. There is no absolute ban on the purchase and/or sale of plaintiff's ethanol as a result of the legislation. Plaintiff is not precluded from doing business in Ohio; nor is any other producer. Plaintiff [*sic*] is presently the only ethanol producer which is indirectly affected by the legislation.

"Plaintiff cites the *Miller, supra*, *Bacchus, Imports, supra*, *Great A & P, supra*, and *Deukmejian v. Nat'l Meat Assoc.*, 53 U.S.L.W. (January 7, 1985, No. 84-720) cases for the proposition that a state cannot favor in-state businesses to the detriment of out-of-state businesses. This is not totally accurate. A state may have a discriminatory tax if such tax does not significantly burden interstate commerce.

"The tax legislation does not ban the sale of products in Ohio manufactured in other states not having a reciprocal provision as in *Great A & P, supra*. The tax does not grant a credit solely for Ohio produced ethanol as in *Bacchus, Imports, supra*. The tax does not tax the use of ethanol differently depending on whether the ethanol was produced in Ohio or out of

Ohio as in *Deukmejian, supra*, and it does not apply a direct commercial advantage to all Ohio producers over all out-of-state producers as in *Miller, supra*, *Boston Stock Exchange, supra*.

"The Supreme Court has consistently held:

"'. . . under our constitutional scheme the states retain "broad power" to legislate protection for their citizens in matters of local concern. Such as public health . . . , and that not every exercise of local power is invalid merely because it affects in some way the flow of commerce between the state. [*Great A & P, supra*, at p. 371].

" . . . .

"'A nondiscriminatory regulation serving substantial state purposes is not invalid simply because it causes some business to shift from a predominantly out-of-state industry a predominantly in-state industry. Only if the burden on interstate commerce clearly outweighs the state's legitimate purposes does such a regulation violate the Commerce Clause. [*Minnesota v. Clover Leaf Creamery Co.* (1981) 449 U.S. 459 at p. 474].'

"The two state court cases in which courts have struck down ethanol tax legislation on Commerce Clause grounds are *Archer Daniels Midland Co. v. State*, 315 N.W. 2<sup>d</sup> 597 (Minn, 1982) and *Miller, supra*. In both cases no tax credit was given for any out-of-state (out of country, in *Miller*) produced ethanol. Even though the plaintiffs in those cases could sell their products in the respective states, the burden on interstate commerce was severe because there was no set of facts which could make them eligible for the exemption. In the case at bar, plaintiff is the only producer affected and it would not have been affected if its state legislature had not abolished its tax credit. It could be said that the

Indiana legislature created the hardship to the plaintiff as much as the Ohio legislature did."

As the trial court correctly noted, this is not a case of economic protectionism, that is, a device to provide a commerce advantage to in-state business over its out-of-state competitors. Although economic protectionism may be found because of either a discriminatory purpose or a discriminatory effect, neither is present here as the trial court correctly found factually and legally. On the other hand, *Bacchus Imports v. Dias* (1984), 104 S. Ct. 3049, was strictly an economic protectionism case since the Supreme Court found that the Hawaii statute involved "had both the purpose and effect of discrimination in favor of local products" (at 3057), since it provides for exemption from taxation only certain products produced in Hawaii, the court noting (at 3057): "It has long been the law that States may not 'build up [their] domestic commerce by means of unequal and oppressive burdens upon the industry and business of other States.'"

The Ohio statute, however, gives no benefit to Ohio producers of ethanol that are not equally available to an out-of-state producer so long as the home state provides incentives to all producers of ethanol, including Ohio producers, on an equal basis. Thus, the Ohio statute serves three basic purposes: (1) it affords an incentive for use of ethanol in gasoline; (2) it encourages other states to afford similar incentives; and (3) it protects Ohio producers against discriminatory ethanol incentive programs which provide incentives only for ethanol produced in that state such as the Indiana incentive program, the benefit of which plaintiff enjoys whether it sells ethanol in Indiana or Ohio. All of these are legitimate state purposes.

Although an equal protection case, the Supreme Court in *Metropolitan Life Ins. Co. v. Ward* (1985), 105 S. Ct. 1676, stated at 1683:

"\* \* \* Under Commerce Clause analysis, the State's interests, if legitimate, is weighed against the burden the state law could impose on interstate commerce. \* \* \*"

In a case involving a regulation rather than a tax, a similar test was applied in *Pike v. Bruce Church, Inc.* (1970), 397 U.S. 139, 90 S.Ct. 844, wherein it is stated at 847:

"Although the criteria for determining the validity of state statutes affecting interstate commerce have been variously stated, the general rule that emerges can be phrased as follows: Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. \* \* \* And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities. Occasionally the Court has candidly undertaken a balancing approach in resolving these issues \* \* \*."

*Pike* found a state statute invalid because of its effect "to require a person to go into a local packing business solely for the sake of enhancing the reputation of other producers within \* \* \* [the state's] borders."

In *Boston Stock Exchange v. State Tax Comm.* (1977), 429 U.S. 318, 97 S.Ct. 599, it is stated at 606:

"On various occasions when called upon to make the delicate adjustment between the national interest in free and open trade and the legitimate interest of the individual States in exercising their taxing powers, the Court has counseled that the result turns on the unique characteristics of the statute at issue and the particular circumstances in each case. \* \* \*"

The court continued with the fundamental principle that: "No State, consistent with the Commerce Clause, may 'impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business.'" The court found the New York transfer tax to be invalid "[b]ecause it imposes a greater tax liability on out-of-state sales than on in-state sales," the obvious effect of which "is to extend a financial advantage to sales on the New York exchanges at the expense of the regional exchange." There is no such effect of the Ohio statute in question, nor does it tax in-state and out-of-state sales at different rates. The *Boston Stock Exchange* court distinguished *Henneford v. Silas Mason Co.* (1937), 300 U.S. 577, 57 S.Ct. 524, which held valid a statute which exempted out-of-state sales from the use tax if a use or sales tax of similar amount had been paid in the state of purchase, finding such a tax structure to be nondiscriminatory. The Ohio tax structure involved is similar, although a partial rebate of taxes rather than an additional tax is involved. The granting of the rebate depends upon the rebate treatment of the state of production. If that state grants a similar rebate with respect to ethanol produced in other states, including Ohio, the Ohio rebate is available, just as the use tax in *Henneford* was not applied if the state of sale imposed and collected a similar tax.

Although the Supreme Court in *Great A & P Tea Co. v. Cottrell* (1976), 424 U.S. 366, 96 S.Ct. 923, held a Mississippi reciprocity requirement invalid, the statute in question prohibited sale in Mississippi of milk processed in another state unless that state's regulatory agency accepted milk processed in Mississippi on a reciprocal basis. Not only does the Ohio statute in question permit, rather than prohibit, sale in Ohio of ethanol produced in other states, but the sale of all gasoline containing ethanol is taxed at the same rate. An after-the-fact (sale) incentive credit is given regardless of the state of production if similar credits are afforded by that state.

The Ohio statute permits, without restriction, the sale in Ohio of gasoline containing ethanol produced in any state. The Ohio statute confers no competitive advantage to an Ohio producer of ethanol over out-of-state producers with respect to sale of ethanol produced in Ohio. The tax imposed on the sale of gasoline including that containing ethanol to Ohio consumers is the same regardless of the state of production. The Ohio statute does provide an incentive credit to Ohio retail dealers in motor vehicle fuel for the sale of gasoline containing ethanol provided the ethanol is produced in a state giving a similar credit with respect to gasoline containing ethanol sold in that state, whether produced in that state or another state, including Ohio.

The Ohio statute does not tax directly or indirectly ethanol produced in another state or in Ohio, nor give an incentive rebate or credit to the producers of ethanol to place them at a competitive advantage. The dealer is free to purchase ethanol from any source and is not required to pass any credit received on either to the producer or the consumer.

Although the evidence indicates that thirty-two states provide tax credits similar to that of Ohio to dealers selling gasoline containing ethanol, including Ohio, Kentucky, Tennessee, Michigan, Illinois, Minnesota and Indiana, only producers of ethanol in Indiana, Illinois, Tennessee, and Ohio are currently furnishing the ethanol which is blended with gasoline for sale in Ohio. Dealers are entitled to the credit or rebate for all ethanol currently being sold in Ohio, including that produced by plaintiff in Indiana, except that the amount of credit received by dealers selling ethanol produced by plaintiff may be less than that received from selling ethanol produced in other states (including Illinois and Tennessee) because Indiana is phasing out its tax-credit incentive program and replacing it with a subsidy-incentive program available only to plaintiff, the subsidy being paid only to Indiana

producers. Unlike the Ohio tax-credit program, the Indiana subsidy program is paid directly to the Indiana producer of ethanol (plaintiff), presumably giving it a competitive advantage over ethanol producers in other states.<sup>1</sup>

Not only does the Ohio statute facially give no competitive advantage to Ohio producers of ethanol, but the evidence indicates that, if the result of the Indiana subsidy program would be to reduce sales by plaintiff of ethanol to Ohio dealers, the primary beneficiaries would be Illinois and Tennessee producers of ethanol, whose sales of ethanol to Ohio dealers would probably increase. Thus, the Ohio statute does not give a direct commercial advantage to Ohio producers of ethanol.

Turning to the abstract statements of law posed as assignments of error, it is difficult to approach them directly because each states a correct principle of law, but those principles do not apply under the Ohio statute and the facts and circumstances involved.

As to the first assignment of error, the Ohio statute does not discriminate upon the basis of state of origin, nor does it place an impermissible burden on interstate commerce for the reasons stated above. The first assignment of error is not well-taken.

The same is true with respect to the second assignment of error. The Ohio statute does not "insist upon reciprocity" but, instead, permits sale of gasoline containing ethanol regardless of the state in which the ethanol was produced. Nor is reciprocity the primary purpose of the

<sup>1</sup> There is no suggestion that the Indiana subsidy law violates the Commerce Clause. Subsidies to attract and promote business are widely used to attract new business to locate in a state and is a legitimate state purpose. Such subsidies, however, necessarily have some effect of giving the beneficiary of the subsidy a competitive advantage over interstate competitors not receiving such subsidy.

dealer credit or rebate program as stated above. Nor does the Ohio law discriminate against out-of-state manufacturers or producers as demonstrated above. The second assignment of error is not well-taken.

While it is true that there may be a Commerce Clause violation even though there is no ban affecting all interstate competitors, the Ohio statute does not *ban* any out-of-state produced ethanol from being sold in Ohio. Furthermore, while an only partial ban does not, *ipso facto*, preclude a Commerce Clause violation, it also does not *ipso facto* establish one. Here, not only is there no ban, but the Ohio statute encourages rather than discourages the sale in Ohio of ethanol produced in other states and gives no commercial competitive advantage to Ohio producers of ethanol over out-of-state producers generally, even assuming that Ohio producers are given the same competitive advantage as Illinois and Tennessee producers (and conceivably those of twenty-eight other states having similar tax-incentive programs). The third assignment of error is not well-taken.

Although a state presumption of constitutional validity cannot overcome a Commerce Clause violation specifically found by the United States Supreme Court, the trial court did not utilize such a presumption as the predicate for its decision. Instead, the trial court specifically and correctly found there to be no Commerce Clause violation under the standards pronounced by the United States Supreme Court. Accordingly, the fourth assignment of error is not well-taken.

On the other hand, the cross-assignment of error of intervening defendant South Point Ethanol, might be well-taken if it were properly before us.

In *Board of Edn. v. Guy* (1901), 64 Ohio St. 434, the Supreme Court adopted the syllabus rule that: "An action to enjoin the levy or collection of a tax can be maintained only by one who is a taxpayer." Accord.

*State, ex rel. Bowers, v. Maumee Watershed Cons. Dist.* (1954), 98 Ohio App. 111. The motor vehicle fuel tax is imposed on and collected from the dealer in motor vehicle fuel, including gasoline. The credit, which is the subject of this action, is paid or credited to such retail motor vehicle fuel dealer. No part of the credit is required by law to be passed on, directly or indirectly, to the producer of ethanol in or out of this state, although the practical effect may be that a dealer will purchase ethanol for which he will receive a tax credit in preference to ethanol for which he will not receive the tax credit, unless the latter is sufficiently lower in price to offset the tax credit.

However, defendant South Point has not filed a notice of appeal and, instead, relies upon R.C. 2505.22 and *Duracote Corp. v. Goodyear Tire & Rubber Co.* (1983), 2 Ohio St. 3d 160. Cross-assignments of error may be raised by an appellee who has not filed a timely notice of appeal only defensively to prevent reversal of a judgment but may not be utilized to obtain affirmative relief. If plaintiff's assignments of error were well-taken, South Point's cross-assignment of error would seek affirmative relief upon an issue determined adversely to it by the trial court, namely, the standing of plaintiff to bring this action but would not affect the basic constitutional issue. Although the question of whether the issue can be raised by a cross-assignment of error of a nonappealing appellee may be a close one, under the unique circumstances of this case, we conclude the cross-assignment of error to be inappropriate. Since we affirm, the issue raised would not be appropriate for determination for that additional reason.

For the foregoing reasons, all four of plaintiff's assignments of error and defendant South Point's cross-assignment of error are overruled, and the judgment of the Franklin County Court of Common Pleas is affirmed.

*Judgment affirmed.*

MCCORMAC, J., concurs.

STERN, J., dissents.

STERN, J., retired Justice of the Ohio Supreme Court, assigned to active duty pursuant to Section 6(C), Article IV, Ohio Constitution.

STERN, J., dissenting.

The preliminary issue of standing must be addressed first. A two-prong test was promulgated by the United States Supreme Court in *Data Processing Service v. Camp* (1970), 397 U.S. 150. First, the court must examine whether the plaintiff has alleged "injury in fact, economic or otherwise." *Id.* at 152. The plaintiff has clearly established such injury. The Ohio tax amendment in effect precludes appellant from doing business in Ohio. Even though appellant itself does not pay the tax or receive the credit, its customers (the retailers) are denied more than half of the available tax credit when they buy from appellant. Consequently, appellant will lose its Ohio customers, who can readily purchase ethanol elsewhere and still receive the full credit. Second, the court must examine "whether the interest sought to be protected is arguably within the zone of interests to be protected or regulated by the statute or constitutional guarantee in question." *Id.* at 153.

Appellant's interest in conducting interstate business free of discriminatory taxes and regulation is clearly within the zone of interests protected by the Commerce Clause. As the United States Supreme Court had noted, " \* \* \* the Commerce Clause was not merely an authorization to Congress to enact laws for the protection and encouragement of commerce among the states, but by its own force created an area of trade free from interference by the states \* \* \*." *Boston Stock Exchange v. State Tax Commission* (1977), 429 U.S. 318, 328, citing

*Freeman v. Hewit* (1946), 329 U.S. 249, 252. Further, appellant's interest in conducting interstate business is regulated by the Ohio law in question.

Appellee South Point Ethanol asserts that appellant lacks standing because it is not a taxpayer. The lack of taxpayer status will not invalidate an action properly commenced by a plaintiff who has met the two-prong test of *Data Processing Service v. Camp*, *supra*. In *Boston Stock Exchange v. State Tax Comm.*, *supra*, the plaintiffs, various stock exchanges located outside New York, challenged the constitutionality of New York's transfer taxes. The stock exchanges were deemed to have standing, even though they were not taxpayers of the state of New York. *Id.* at 320, n.3. Thus, appellee's assertion that taxpayer status is required is erroneous. The facts reveal that appellant is not a "taxpayer" in relation to the challenged statute. Appellant, however, is directly affected by the statute and will suffer economic injury. Thus, it has standing under the *Boston Stock Exchange* case.

In a case clearly parallel to the instant case, the Supreme Court of Florida held that brokers and importers of foreign ethyl alcohol (ethanol) had standing to challenge a Florida tax law. *Miller v. Publicker Industries, Inc.* (Fla. S.Ct. 1984), 457 So.2d 1374. In *Miller*, the state of Florida attempted to exempt only United States produced ethyl alcohol from the fuel tax. Thus, Florida retailers would not purchase the plaintiff's product or would require plaintiffs to substantially reduce the price of their product. The court held that the devastating effect this statute had on plaintiff's business was sufficient to confer standing. *Id.* at 1375. The court rejected the defendant's "restrictive view" that, simply because the plaintiff was not a taxpayer, it had no standing. *Id.* "The legislature may not protect a tax statute from constitutional review merely by ensuring that someone other than the party whose business is adversely affected must

pay the tax." *Id.* at 1375-1376. In the instant case, the Ohio legislature similarly may not prevent appellant from challenging the statute merely by ensuring that the ethanol retailers pay the tax. Clearly, it is appellant's business which will suffer the economic effect of this statute. Thus, I would hold that appellant has standing.

The free flow of goods between the states is protected by the Commerce Clause of the United States Constitution. "The Commerce Clause forbids discrimination, whether forthright or ingenious." *Best & Co. v. Maxwell* (1940), 311 U.S. 454, 455; *Dayton Power and Light Co. v. Lindley* (1979), 58 Ohio St. 2d 465, 468. This court has a duty to evaluate R.C. 5735.145(B) to determine whether, in practical operation, it will discriminate against interstate commerce. *Id.*

The Supreme Court outlined the general rule regarding the validity of state statutes affecting interstate commerce in *Pike v. Bruce Church, Inc.* (1970), 397 U.S. 137. "Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits." *Id.* at 142. The conclusion which must be drawn from applying this rule to the instant statute is that it violates the Commerce Clause.

The Ohio statute does not regulate even-handedly: it makes a distinction between the origin of the ethanol, giving an advantage to all in-state and some out-of-state producers. The appellees contend that the instant statute is distinguishable from those struck down in *Boston Stock Exchange v. State Tax Comm.*, *supra*, and *Dayton Power & Light Co. v. Lindley*, *supra*, because in those cases the statutes favored by state producers at the expense of *all* out-of-state producers. Even if this may be true, the distinction is without a difference. As the

court noted in the *Boston Stock Exchange* case, the fact that a statute discriminates between two kinds of interstate transactions, rather than discriminating against interstate commerce in favor of intrastate commerce, is irrelevant—both types of statutes are unconstitutional. *Id.* at 333.

The same result was reached in *Best & Co., Inc., v. Maxwell, supra*. In that case, a privilege tax was imposed on companies which sold merchandise in North Carolina, but were not regular retail merchants in the state. *Id.* at 455. The statutory scheme thus preferred all in-state companies and some out-of-state companies (those who were regular merchants) over other out-of-state companies (those who were not regular merchants). The Supreme Court held that the statute was unconstitutional because it interfered with the freedom of commerce. *Id.* at 457. If the key to the Commerce Clause is even-handed treatment, then, certainly, a statute which favors all in-state producers and some, but not all, out-of-state producers, is unconstitutional.

Even if this court were to hold that the Ohio statute regulates even-handedly, it nevertheless does not meet the other two prongs of the *Pike* test. First, appellees failed to adequately show that the statute effectuates a legitimate local public interest. The trial court noted that there were two interests advanced by appellee for the legislation: to keep the air clean around Ohio and to encourage other state legislatures to pass similar tax credit legislation. Further, the trial court held that the legislative purpose of promoting domestic industry and affecting other state's policies is legitimate. I cannot agree.

The clean air argument, upon which appellees heavily rely, is suspect at best. As noted above, even the trial court did not rely on the clean air argument to find a legitimate state purpose. Appellees argue at length

about how the environment in and around Ohio can be improved by the use of ethanol. Such "sanitary security" arguments have been routinely rejected by the courts. *Baldwin v. G.A.F. Seelig, Inc.* (1935), 294 U.S. 511; *Great A & P Tea Co. v. Cottrell* (1976), 424 U.S. 366; *Philadelphia v. New Jersey* (1978), 437 U.S. 617.

Although clothed in terms of public health, the legislative purpose of R.C. 5735.145(B) is clear—forced reciprocity. The section states, in part:

"The qualified fuel otherwise eligible for the qualified fuel credit shall *not* contain ethanol produced *outside Ohio unless* \* \* \* the fuel claimed to be eligible \* \* \* contains ethanol produced in a state that also grants an exemption, credit or refund \* \* \* for similar fuel containing ethanol *produced in Ohio.* \* \* \*" R.C. 5735.145(B) (Emphasis added.)

Thus, for a foreign state's ethanol to qualify for the credit in Ohio, the foreign state must give *Ohio producers* a similar credit in that state.

The United States Supreme Court has struck down forced reciprocal statutes as violative of the Commerce Clause. In *Baldwin v. G.A.F. Seelig, supra*, New York attempted to control the price of milk by providing that out-of-state milk could not be sold in state if the foreign state did not pay at least the New York minimum price for milk. The court held the statute unconstitutional, noting that distinctions between direct and indirect burdens are irrelevant when the purpose of the obstruction of commerce, as well as its necessary tendency, is to suppress or mitigate the consequences of competition between the states. *Id.* at 522. Clearly, the necessary tendency of the Ohio statute is to suppress or mitigate competition. Producers from states which do not grant Ohio producers a tax credit are, for practical purposes, precluded from competing in Ohio.

This conclusion was reaffirmed in *Great A & P Tea Co. v. Cottrell, supra*. In that case, Mississippi's forced reciprocity statute for milk sales was struck down as violative of the Commerce Clause. While voluntary reciprocity may be used by a state to promote its economy, forced reciprocity is forbidden. *Id.* at 378-379. In the instant case, Ohio is attempting to force its sister states to grant Ohio producers a tax credit. This forced reciprocity cannot be sustained.

The final prong of the *Pike* test requires an examination of the effects the Ohio statute will have on interstate commerce. As previously noted, the effects on interstate commerce will be devastating. Countless producers of ethanol will be unable to sell their product in Ohio if they are unlucky enough to be located in a state which does not grant at least two and one-half cents per gallon tax credit for Ohio-produced ethanol. This scheme places barriers to the free flow of commerce which cannot be viewed as "incidental."

When balancing the burden imposed on interstate commerce in relation to the putative local benefits of the Ohio statute, it is clear that the statute must be deemed unconstitutional. See *Pike v. Bruce Church, Inc., supra*, citing *Huron Cement Co. v. Detroit*, 362 U.S. 440, 443.

I, therefore, respectfully dissent from the majority opinion.

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IN THE COURT OF APPEALS OF OHIO  
TENTH APPELLATE DISTRICT

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No. 85AP-340

(REGULAR CALENDAR)  
NEW ENERGY COMPANY OF INDIANA,  
*Plaintiff-Appellant,*  
v.

JOANNE LIMBACH *et al.*,  
*Defendants-Appellees.*

---

JOURNAL ENTRY OF JUDGMENT

For the reasons stated in the opinion of this court rendered herein on May 8, 1986, the assignments of error are overruled, and defendant South Point's cross-assignment of error is overruled, and it is the judgment and order of this court that the judgment of the Franklin County Court of Common Pleas is affirmed.

WHITESIDE and McCORMAC, JJ.

By Judge Alba L. Whiteside  
Alba L. Whiteside

cc: David J. Young,  
Kevin R. McDermott and  
John K. Lines  
Herman Schwartz  
Richard C. Farrin  
David C. Crago,  
James R. King and  
Gail E. Griffith

IN THE COURT OF COMMON PLEAS  
OF FRANKLIN COUNTY, OHIO  
CIVIL DIVISION

---

Case No. 85CV-02-712

NEW ENERGY COMPANY OF INDIANA,  
Plaintiff,  
vs.

JOANNE LIMBACH, TAX COMMISSIONER, et. al.,  
Defendants.

---

JUDGE CRAWFORD

---

DECISION

**FINDINGS OF FACT**

(1) The Court has adopted as its findings, the "Amended Agreed Finding of Fact" submitted by all parties on April 10, 1984. In addition, the Court has adopted plaintiff's four additional findings of fact and defendants' additional finding of fact submitted on April 10, 1985. Further, the Court will take judicial notice of the plaintiff's application for Registration of Foreign Limited Partnership and the Report of Use of Fictitious Name, each of which was filed after the hearing date of the case.

(2) Additional Finding by the Court.

*Revised Code* Section 5735.145 was enacted in 1981 which granted the tax credit to dealers for the use of ethanol. The only meaningful change that was made in the legislation was effective January 1, 1985, and is the

reciprocal tax credit provision which is the subject of this litigation.

**CONCLUSIONS OF LAW**

(1) *Plaintiff has standing to challenge the constitutionality of Rev. Code Section 5735.145(B).*

In general, standing requires that the party seeking relief suffer injury in fact and that the interest sought to be protected be within the zone of interests protected by the constitutional provision invoked. (*Valley Forge Christian College v. Americans United for Separation of Church and State* (1982) 454 U.S. 464, 472-73). Even though it is desirable that the party seeking to attack taxation legislation be a taxpayer (*Board of Education v. Guy* (1901) 64 Ohio St. 434, *State ex rel Bowers v. Maumee Watershed Conservancy District* (1954) 98 Ohio App. 111), it is not necessary in all cases. The United States Supreme Court, in a case in which the tax commissioner argued that stock exchanges do not have standing to question the constitutionality of a transfer tax statute, held:

"The exchanges are asserting their right to engage in interstate commerce free of discriminatory taxes on their business and they allege that the transfer tax indirectly infringes on that right. Thus, they are 'arguably within the zone of interests to be protected [by the constitution]' "

[*Boston Stock Exchange v. State Tax Comm'r* (1977) 429 U.S. 318 at p. 320]

Similarly, the Court held that wholesalers have standing to attack a discriminatory tax if it has an "adverse competitive impact on their business." (*Bacchus Imports, Ltd. v. Dias* (1984) 468 U.S. —, 82 L. Ed. 2d 200 at p. 207).

The Florida Supreme Court was confronted with a case very similar to the one before this Court. In *Miller v.*

*Publicker Industries, Inc.*, No. 65, 839 (Oct. 11, 1984), the Court held that an out-of-country supplier of ethanol could challenge Florida's ethanol tax-credit legislation which precluded foreign suppliers from the applicability of the ethanol tax-credit.

A party may challenge the constitutionality of a statute after showing that enforcement of the statute will injuriously affect the plaintiff's personal property rights . . . . In the present case Publicker presented evidence that, due to removal of the exemption on gasohol with foreign source alcohol, blender/distributors of gasohol in Florida either will not purchase or will require a substantial reduction in price before purchasing foreign ethyl alcohol. Publicker demonstrated the devastating effect this statute has had on its business. It must continue to pay fixed expenses while unable to sell its alcohol in Florida at an economically viable price. The legislature may not protect a tax statute from constitutional review merely by ensuring that someone other than the party whose business is adversely affected must pay the tax . . . . We therefore agree with the trial court's finding that Publicker had standing to challenge [the statute] . . . .

[*Miller v. Publicker Industries, Inc.*, *supra*]

In the case at bar, failure of the plaintiff to have its ethanol subject to the tax credit will have a major impact on its business in Ohio. If defendants' arguments are sustained, the legislation could not be challenged. In *Guy*, *supra*, and *Maumee Watershed*, *supra*, there were alternate routes for the plaintiffs to follow to challenge the tax. In this case, there are not alternate routes for the plaintiff to follow. In all likelihood, no dealer will purchase plaintiff's product because it is not subject to the tax credit. In addition, if a dealer does purchase the plaintiff's ethanol and then challenges the legislation, it is possible that it would not have standing to raise

either the Equal Protection or the Commerce Clause arguments of plaintiff.

Defendants assert that *Rev. Code* Section 5703.38 precludes plaintiff from seeking the injunction against the tax commissioner. This action seeks a declaratory judgment and an injunction pursuant to *Rev. Code* Section 2723.01. The anti-injunction provisions of *Rev. Code* Section 5703.38 deals with cases in which the Department of Taxation has issued an order or a determination regarding a particular taxpayer from which the taxpayer has alternative remedies to pursue a challenge. This Court does not believe that the legislature intended that *Rev. Code* Section 5703.38 supercedes *Rev. Code* Section 2723.01 and *Rev. Code* 2721.03 in that it precludes all injunctions against all tax legislation.

(2) *Revised Code* Section 5735.145(B) is presumed constitutional unless proven unconstitutional beyond a reasonable doubt.

"The judiciary may not sit as a super-legislature to judge the wisdom or desirability of legislative policy . . . ."

[*New Orleans v. Dukes*, 42 U.S. at 303]

Because of our role as interpreters of legislation, rather than makers, legislation is given a great presumption of constitutionality. The Ohio Supreme Court held, in *State, ex rel, Swetland v. Kinney*, 1982 69 Ohio St. 2d 567:

"A regularly enacted statute of Ohio is presumed to be constitutional and is therefore entitled to the benefit of every presumption in favor of its constitutionality unless such enactments are clearly unconstitutional beyond a reasonable doubt.

\* \* \* \*

"The legislative judgment in this behalf will not be nullified except when it clearly appears that there has been a gross abuse of such discretion in un-

doubted violation of some state or federal constitutional provision."

[*Swetland, supra* at p. 574]

(3) *Revised Code Section 5735.145(B) does not violate the Privileges and Immunities Clause of the United States Constitution.*

The Plaintiff is an Indiana limited partnership. It is not a citizen for purposes of the Privileges and Immunities Clause of the United States Constitution. (*Western and Southern Life Ins. Co. v. State Board of Education* (1981) 451 U.S. 648, and *Hemphill v. Orloff* (1928) 277 U.S. 537.

(4) *Revised Code Section 5735.145(B) does not violate the Equal Protection Clause of the United States Constitution.*

Both sides have directed this Court to the March 26, 1985, decision of the United States Supreme Court in *Metropolitan Life Insurance Co. v. Ward*, — U.S. —, No. 83-1274. In that case the Supreme Court found that Alabama's domestic preference tax, which taxes out-of-state insurance companies at a higher rate than domestic insurance companies, violates the Equal Protection Clause of the United States Constitution. The case did not involve a Commerce Clause attack because Congress has exempted insurance companies from Commerce Clause restrictions pursuant to the McCarran-Ferguson Act, 15 USC Section 1011.

It is obvious from reading the majority and the dissent that the *Ward, supra*, case was a close call for the Court. It is also clear that this is the most recent statement of the Court on the subject of Equal Protection and is binding on this Court.

In *Ward, supra*, the Alabama legislature granted a preference to its domestic insurance companies by imposing a lower gross premium tax on domestic companies

than it did for out-of-state companies. In general out-of-state companies paid three or four times as much gross premium taxes as did its domestic competitors. Out-of-state companies could reduce the differential by investing their assets in domestic assets and securities; however, in no event could the out-of-state companies ever reduce their tax rate to that of the domestic companies. The Court found that the sole purpose of the legislation was "to favor domestic industry within the state, no matter what the cost to foreign corporations also seeking to do business there." [at p. 8 of the Opinion].

In citing *Western & Southern Life Ins. Co. v. State Board of Equalization of Calif* (1981) 451 U.S. 648, the Court in *Ward, supra*, established the test to be used in cases in which out-of-state corporations are discriminated by way of tax legislation.

"... whatever the extent of a state's authority to exclude foreign corporations from doing business within its boundaries, that authority does not justify imposition of more onerous taxes or other burdens on foreign corporations than those imposed on domestic corporations, unless the discrimination between foreign and domestic corporations bears a rational relationship to a legitimate state purpose."

[at p. 5 of the Opinion]

In deciding whether a particular piece of legislation complies with the Equal Protection Clause, a Court must first determine the legislature's purpose in enacting the legislation. "If the State's purpose is found to be legitimate, the state law stands as long as the burden it imposes is found to be rationally related to that purpose, a relationship that is not difficult to establish." (at p. 11 of the Opinion). Further, the Court cited *United States v. Carolene Products Co.* (1938) 304 U.S. 144 at p. 154, and held "if the purpose is legitimate, equal protection challenge may not prevail so long as the question of ra-

tional relationship is 'at best debatable.'" '(The dissent agreed with the foregoing test. See Dissent, p. 11).

In the case at bar, it is clear from the Findings of Fact that the original 1981 legislation had several legitimate purposes. (Findings, 10, 11). All parties agree that tax credits for the use of ethanol is a legitimate state purpose and imposes only a minor burden on gasoline producers. However, it is not agreed that the 1985 reciprocal tax credit amendment carries with it the legitimate purposes of the original act. Plaintiff argues that the only purpose to the amendment is to favor in-state producers by discriminating against out-of-state producers as in *Ward, supra*. Defendants argue that while in-state producers may receive a benefit, the purpose of the legislation is to keep the air clean around Ohio and to encourage other state legislatures to pass similar tax credit legislation. (Or not to abolish existing legislation). The Supreme Court in *Western and Southern, supra*, recognized that discriminatory tax legislation can have a legitimate purpose if it is intended to influence the policies of other state legislatures. The Court in *Ward* held, at p. 8 of the Opinion:

"Alabama has made no attempt, as California did, to influence the policies of other states in order to enhance its domestic companies' ability to operate interstate; rather, it has erected barriers to foreign companies who wish to do interstate business in order to improve its domestic insurers' ability to compete at home."

In *Ward, supra*, as in *Miller, supra*, *Bacchus Imports, supra*, and *Boston Stock Exchange*, there was absolute discrimination against out-of-state producers in their respective tax legislation. When legislation creates absolute favoritism in favor of domestic companies the purpose is inherently suspect. (*Ward*, dissent, p. 11). In the case at bar, there is no absolute favoritism. The tax

credit is available to all dealers in Ohio; and if an out-of-state producer has reciprocal tax-credit legislation, dealers receive the tax credit on all ethanol sold.

The Court thus finds that:

- a. The legislation is given a strong presumption of constitutionality;
- b. The plaintiff will be significantly damaged by the effect of the legislation;
- c. The legislature's purpose of promoting domestic industry *and* to affect the policies of other states to grant reciprocal tax credits, is a legitimate purpose—at least debatably;
- d. The legislation bears a rational relation to its legitimate purpose.

(5) *Revised Code Section 5735.145(B)* does not violate the Commerce Clause of the United States Constitution.

The Commerce Clause is intended to protect interstate commerce from restrictive legislation rather than protecting individuals. (As in the case with the Equal Protection Clause—See *Ward, supra*, at p. 11 of the Opinion).

This Court has previously held that the purpose of the legislation in enacting *Rev. Code 5735.145(B)* was legitimate. The Court has further held that the plaintiff will receive a economic hardship as a result of the legislation; however, this Court has not found that the legislation will impose a significant burden on interstate commerce. There is no absolute ban on the purchase and/or sale of plaintiff's ethanol as a result of the legislation. Plaintiff is not precluded from doing business in Ohio; nor is any other producer. Plaintiff is presently the only ethanol producer which is indirectly affected by the legislation.

Plaintiff cites the *Miller, supra*, *Bacchus, Imports, supra*, *Great A & P, supra*, and *Deukmejian v. Nat'l Meat Assoc.*, 53 U.S.L.W. (January 7, 1985, No. 84-720)

cases for the proposition that a state cannot favor in-state businesses to the detriment of out-of-state businesses. This is not totally accurate. A state may have a discriminatory tax if such tax does not significantly burden interstate commerce.

The tax legislation does not ban the sale of products in Ohio manufactured in other states not having a reciprocal provision as in *Great A & P, supra*. The tax does not grant a credit solely for Ohio produced ethanol as in *Bacchus, Imports, supra*. The tax does not tax the use of ethanol differently depending on whether the ethanol was produced in Ohio or out of Ohio as in *Deukmejian, supra*, and it does not apply a direct commercial advantage to all Ohio producers over all out-of-state producers as in *Miller, supra, Boston Stock Exchange, supra*.

The Supreme Court has consistently held:

"... under our constitutional scheme the states retain 'broad power to legislate protection for their citizens in matters of local concern. Such as public health . . . , and that not every exercise of local power is invalid merely because it affects in some way the flow of commerce between the state.

[*Great A & P, supra* at p. 371].

\* \* \* \*

"A nondiscriminatory regulation serving substantial state purposes is not invalid simply because it causes some business to shift from a predominantly out-of-state industry to a predominantly in-state industry. Only if the burden on interstate commerce clearly outweighs the state's legitimate purposes does such a regulation violate the Commerce Clause.

[*Minnesota v. Clover Leaf Creamery Co.* (1981) 449 U.S. at p. 474].

The two state court cases in which courts have struck down ethanol tax legislation on Commerce Clause grounds

are *Archer Daniels Midland Co. v. State*, 315 N.W. 2d 597 (Minn, 1982) and *Miller, supra*. In both cases no tax credit was given for any out-of-state (out of country, in *Miller*) produced ethanol. Even though the plaintiffs in those cases could sell their products in the respective states, the burden on interstate commerce was severe because there was no set of facts which could make them eligible for the exemption. In the case at bar, plaintiff is the only producer affected and it would not have been affected if its state legislature had not abolished its tax credit. It could be said that the Indiana legislature created the hardship to the plaintiff as much as the Ohio legislature did.

This Court is not holding that all reciprocal tax credit legislation is a valid exercise of state power. If the credit legislation affected all out-of-state producers, and/or if the legislation created a scheme that made it impossible for all producers to compete with Ohio companies, the result may be different. This is a very close case (on all issues except the Privileges and Immunities Clause). Remembering that the legislation receives a strong presumption in favor of its constitutionality, the Court holds that it does not violate the Commerce Clause of the United States Constitution.

Dale A. Crawford  
DALE A. CRAWFORD  
Judge

#### COPIES TO:

John K. Lines, Esq.  
Attorney for Plaintiff

Richard C. Farrin, Esq.  
Attorney General's Office  
Attorney for Joanne Limbach  
and Mary Ellen Withrow

David C. Crago, Esq.  
Attorney for South Point Ethanol

IN THE COURT OF COMMON PLEAS  
OF FRANKLIN COUNTY, OHIO  
CIVIL DIVISION

Case No. 85CV-02-712

NEW ENERGY COMPANY OF INDIANA,  
vs. *Plaintiff,*

JOANNE LIMBACH, TAX COMMISSIONER, *et. al.,*  
*Defendants.*

JUDGE CRAWFORD

JUDGMENT ENTRY

Judgment is hereby rendered in favor of the Defendants in accordance with this Court's Decision of April 23, 1985.

The Court finds that *Revised Code* Section 5735.145 does not violate the Privileges and Immunities, the Equal Protection or the Commerce Clauses of the United States Constitution. Case Dismissed.

Costs to Plaintiff.

DATE:

Dale A. Crawford  
DALE A. CRAWFORD  
Judge

APPROVED:

John K. Lines, Esq.  
Attorney for Plaintiff

Richard C. Farrin, Esq.  
Attorney General's Office  
Attorney for Joanne Limbach  
and Mary Ellen Withrow

David C. Crago, Esq.  
Attorney for South Point Ethanol

R.C. § 5735.145(B)

(B) The qualified fuel otherwise eligible for the qualified fuel credit shall not contain ethanol produced outside Ohio unless the tax commissioner determines that the fuel claimed to be eligible for credit contains ethanol produced in a state that also grants an exemption, credit or refund from such state's motor vehicle fuel excise tax or sales tax for similar fuel containing ethanol produced in Ohio; provided however, that such credit shall not exceed the amount of the credit allowable for qualified fuel containing ethanol produced in Ohio.

## STATE OF TENNESSEE

[SEAL]

Office of the Attorney General  
450 James Robertson Parkway  
Nashville, Tennessee 37219

June 27, 1983

William M. Leech, Jr.	Deputy Attorney General
Attorney General's Reporter	Donald L. Corlew
William B. Hubbard	Jimmy G. Creecy
Chief Deputy Attorney General	Robert A. Grunow
Robert B. Littleton	William J. Haynes, Jr.
Special Deputy for Litigation	Robert E. Kenorick
	Michael E. Terry

Mrs. Martha B. Olsen, Commissioner  
Department of Revenue  
Andrew Jackson SO Bldg.  
Nashville, Tennessee 37242

Dear Commissioner Olsen:

You have requested the opinion of this office with respect to the following matters:

## QUESTIONS

1. Is Section 9, Chapter 911, Public Acts of 1982 unconstitutional because it mandates different tax rates on gasohol, depending on whether the gasohol was produced in Tennessee, in a state which provides gasohol tax relief, or in a state which does not provide gasohol tax relief?

2. If Section 9, Chapter 911, Public Acts of 1982 is constitutional, how should the Department of Revenue

calculate the tax on gasohol imported into Tennessee from states which provide less tax relief than Tennessee?

## OPINIONS

1. Section 9, Chapter 911, Public Acts of 1982 is unconstitutional because it violates the Commerce Clause of the United States Constitution under the holding by the United States Supreme Court in *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318 (1977).

2. Your second question is rendered moot by our opinion in connection with the first question.

## ANALYSIS

Chapter 911, Public Acts of 1982 amends those provisions of the Tennessee Code which deal with the gasoline tax by providing for a special tax scheme for gasohol. Section 9 of Chapter 911 and its constitutional implications are the focus of our inquiry. Section 9 provides:

The provisions of this Act shall apply to gasohol manufactured from ethyl alcohol manufactured in Tennessee and shall apply to gasohol manufactured in any state which reduces the rate of taxation or exempts from its motor fuel tax gasohol manufactured from ethyl alcohol manufactured in Tennessee, provided that any gasohol imported into Tennessee or any gasohol manufactured from ethyl alcohol imported into Tennessee shall be taxed at the same rate and in the same manner as gasohol manufactured from ethyl alcohol manufactured in Tennessee, regardless of the rate of taxation on gasohol or ethyl alcohol in the state from which such gasohol or ethyl alcohol is imported, except that in no case shall the amount of tax relief granted gasohol or ethyl alcohol imported into Tennessee exceed the amount of relief granted by the exporting state.

Thus this section affords the tax relief granted by Chapter 911 to all "in state" gasohol. Gasohol imported from states which do not provide gasohol tax relief do not receive Tennessee tax relief. Gasohol imported from states which do provide gasohol tax relief is afforded Tennessee tax relief except that such Tennessee tax relief is reduced where the tax relief provided by the exporting state is less than the Tennessee tax relief.

Article 1, Section 8, Clause 3, the "Commerce Clause," of the United States Constitution provides:

The Congress shall have power to . . . regulate commerce . . . among the several states, . . .

The purpose of the Commerce Clause was "to create an area of free trade among the states." *McLeod v. J.E. Dilworth Co.*, 322 U.S. 327 (1944). States are prohibited from unduly burdening interstate commerce with discriminatory taxes and regulations. *Freeman v. Hewit*, 329 U.S. 249 (1946). See also *Halliburton Oilwell Co. v. Reily*, 373 U.S. 64 (1963); *Nippert v. Richmond*, 327 U.S. 416 (1946); *I.N. Darnell & Son v. Memphis*, 208 U.S. 113 (1908); *Guy v. Baltimore*, 100 U.S. 434 (1880); *Welton v. Missouri*, 91 U.S. 275 (1876).

The most recent pronouncement by the United States Supreme Court with respect to Commerce Clause restrictions on state taxation is *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318 (1977). In that case the court considered a New York tax on stock transfers, which tax discriminated on the basis of whether or not stock sales were made in New York by taxing New York sales at a preferential rate. The court invalidated the New York tax, holding that the tax violated the Commerce Clause of the United States Constitution. The court stated:

[T]he fundamental principal that we find dispositive of this case . . . [is]: [n]o state, consistent with the Commerce Clause may impose a tax which

discriminates against interstate commerce . . . by providing a direct commercial advantage to local businesses.

*Id.* at 330.

The *Boston Stock Exchange* case would appear to prohibit a tax scheme such as that set forth in Chapter 911. The Tennessee tax on imported gasohol varies according to the gasohol taxation structure in the exporting state. The reciprocity provision does not mitigate the possibility of discrimination against interstate commerce because gasohol manufacturers do not dictate their states' taxation structures. A gasohol manufacturer from a state whose legislature has not directed gasohol tax relief will be taxed by Chapter 911 on Tennessee gasohol imports at a higher rate than a manufacturer from Tennessee or a state which does afford gasohol tax relief. Such discriminatory taxation has the effect of interfering with interstate commerce by providing a direct commercial advantage to local gasohol manufacturers and to those gasohol manufacturers in states which have gasohol tax relief. This discrimination against interstate commerce is precisely what the *Boston Stock Exchange* decision prohibits. It is the opinion of this office, therefore, that Section 9, Chapter 911, Public Acts of 1982 is unconstitutional.

Sincerely,

/s/ William M. Leech, Jr.  
WILLIAM M. LEECH, JR.  
Attorney General

/s/ William B. Hubbard  
WILLIAM B. HUBBARD  
Chief Deputy Attorney General

/s/ Gregory L. Nelson  
GREGORY L. NELSON  
Assistant Attorney General

## EXHIBIT A

[SEAL]

NEIL F. HARTIGAN  
 Attorney General  
 State of Illinois  
 Springfield  
 62706

June 20, 1985

Honorable William A. Marovitz  
 Illinois State Senator  
 105-A State Capitol  
 Springfield, Illinois 62706

Dear Senator Marovitz:

I have your letter wherein you inquire regarding the constitutionality of Senate Bill 254, introduced in the Eighty-fourth General Assembly. Because of the nature of your question, I do not believe that an official opinion of the Attorney General is necessary. I will, however, comment informally upon your request.

If enacted, Senate Bill 254 would amend section 3 of the Use Tax Act (Ill. Rev. Stat. 1985 Supp., ch. 120, par. 439.3) and impose a tax upon gasohol manufactured outside the State of Illinois at a rate different from that produced within the State of Illinois unless the State of production grants an exemption, credit, or refund from that jurisdiction's fuel excise tax, sales tax, or similar tax to gasohol produced in the State of Illinois. Senate Bill 254 provides in part as follows:

"\* \* \* [W]ith respect to gasohol in which the ethanol has been distilled in Illinois, such [use] tax shall be imposed at the rate of 0% up to and in-

cluding December 31, 1983; and at the rate of 1% from January 1, 1984 up to and including June 30, 1985; and at the rate of 1%, plus an additional 1% for each one cent reduction in the Federal Excise Tax on a gallon of gasohol occurring after June 30, 1985, from July 1, 1985 up to and including December 31, 1992; and at the rate of 5% thereafter. If the Department of Revenue certifies that another jurisdiction outside the State of Illinois provides an exemption, credit, or refund from that jurisdiction's motor fuel excise tax, sales tax or similar tax that is applicable to gasohol which contains denatured ethanol distilled in Illinois, then gasohol containing ethanol distilled in the other jurisdiction and purchased on or after July 1, 1985, shall be eligible for the exemption provided in this Section only to the level of exemption, credit, or refund that gasohol containing ethanol distilled in Illinois would receive in such other jurisdiction, but not to exceed the level of exemption provided for gasohol containing ethanol distilled in Illinois. All denatured ethanol for blending into gasohol which is paid for and in Illinois storage facilities prior to July 1, 1985, shall qualify for the exemption available under this Section for gasohol containing ethanol distilled in Illinois. The Department shall maintain gallonage records for exemptions claimed on gasohol sold at retail which qualify under this Act. \* \* \*

It appears that Senate Bill 254 is constitutionally infirm in that it violates the Commerce Clause of the United States Constitution (U.S. Const., art. I, § 8, cl. 3), which provides as follows:

"The Congress shall have Power \* \* \* To regulate Commerce \* \* \* among the several States \* \* \*;

\* \* \*

The purpose of the Commerce Clause was to create an area of free trade among the States. The Commerce Clause not only authorizes Congress to enact laws for the protection and encouragement of commerce among the States, but by its own force creates an area of trade free from interference by the States. (*Boston Stock Exchange v. State Tax Commission* (1977), 429 U.S. 318, 97 S. Ct. 599, 606.) The Commerce Clause acts as a limitation upon States in encouraging domestic business and industry by imposing a discriminatory tax upon interstate commerce. (*Bacchus Imports, Ltd. v. Dias* (1984), — U.S. —, 104 S. Ct. 3049, 3056-57.) In *Maryland v. Louisiana* (1981), 451 U.S. 725, 101 S. Ct. 2114, wherein a Louisiana statute, which imposed a tax upon natural gas brought into the State of Louisiana for processing, eventually to be sold to out-of-state consumers, was struck down, the Supreme Court held as follows:

“\* \* \* Prior case law has established that a state tax is not *per se* invalid because it burdens interstate commerce since interstate commerce may constitutionally be made to pay its way. [Citations.] *The State's right to tax interstate commerce is limited, however, and no state tax may be sustained unless the tax: (1) has a substantial nexus with the State; (2) is fairly apportioned; (3) does not discriminate against interstate commerce; and (4) is fairly related to the services provided by the State.* [Citation.] One of the fundamental principles of Commerce Clause jurisprudence is that no State, consistent with the Commerce Clause, may ‘impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business.’ [Citations.] This antidiscrimination principle ‘follows inexorably from the basic purpose of the Clause’ to prohibit the multiplication of preferential trade areas destructive of

the free commerce anticipated by the Constitution. [Citations.]

\* \* \* \*

(Emphasis added.) *Maryland v. Louisiana* (1981), 451 U.S. 725, 101 S. Ct. 2114, 2133.

In *Boston Stock Exchange v. State Tax Commission* (1977), 429 U.S. 318, 97 S. Ct. 599, certain stock exchanges located outside the State of New York brought an action challenging a New York State statute which imposed a heavier transfer tax on out-of-state securities transactions than securities transactions within the State of New York. The intent of the New York legislature in imposing a heavier tax burden on out-of-state securities transactions over intra-state transactions was to afford a degree of economic protection to the New York based stock exchanges. Ruling that the New York tax was invalid, the Supreme Court held:

\* \* \* \*

\* \* \* No State, consistent with the Commerce Clause, may ‘impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business.’ \* \* \*

\* \* \* \*

\* \* \* We hold only that in the process of competition no State may discriminatorily tax the products manufactured or the business operations performed in any other State.

\* \* \* \*

*Boston Stock Exchange v. State Tax Commission* (1977), 429 U.S. 318, 97 S. Ct. 599, 607-10.

In *Bacchus Imports, Ltd. v. Dias* (1984), — U.S. —, 104 S. Ct. 3049, the Supreme Court considered the constitutionality of a liquor tax imposed by the State of Hawaii on the sales of liquor. The sale of certain locally produced liquor, however, was exempted from the tax.

The State of Hawaii posited that the purpose of the preferred treatment for local products was not to discriminate against interstate commerce but to promote the local industry. As in *Boston Stock Exchange v. State Tax Commission*, the court struck down the Hawaii tax as unlawful economic protectionism, holding as follows:

\* \* \*

\* \* \* [W]e need not guess at the legislature's motivation, for it is undisputed that the purpose of the exemption was to aid Hawaiian industry. Likewise, the effect of the exemption is clearly discriminatory, in that it applies only to locally produced beverages, even though it does not apply to all such products. Consequently, as long as there is some competition between the locally produced exempt products and non-exempt products from outside the State, there is a discriminatory effect.

\* \* \*

*Bacchus Imports, Ltd. v. Dias* (1984), — U.S. —, 104 S. Ct. 3049, 3056.

It appears that Senate Bill 254, if enacted, would impose a tax which discriminates against interstate commerce. The exemption contained therein applies only to ethanol produced in the State of Illinois and to ethanol produced in other jurisdictions which exempt ethanol produced in Illinois from their taxes on gasohol. Consequently, a gasohol manufacturer from a State whose legislature does not provide for gasohol tax relief would be taxed at a higher rate than a manufacturer from Illinois or a State which does afford gasohol tax relief. Such a discriminatory tax would provide a direct economic advantage to Illinois gasohol producers and to those producers from other States benefiting from the reciprocity provision and, hence, would constitute an undue interference with interstate commerce. Accordingly, it appears that Senate Bill 254 is unconstitutional.

This is not an official opinion of the Attorney General. If I can be of any further assistance, please advise.

Very truly yours,

/s/ Shawn W. Denney  
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Chief  
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SWD:CRS:vl

78a

IN THE SUPREME COURT OF OHIO

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Case No. 86-784

NEW ENERGY OF INDIANA,  
*Appellant,*

—vs.—

JOANNE LIMBACH, TAX COMMISSIONER OF OHIO, *et al.*,  
*Appellees.*

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NOTICE OF APPEALS TO THE  
SUPREME COURT OF THE UNITED STATES

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[Filed Oct. 9, 1987]

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Notice is hereby given that New Energy of Indiana, the appellant above-named, hereby appeals to the Supreme Court of the United States from the final judgment and mandate of the Supreme Court of the State of Ohio, entered in this action on September 2, 1987, affirming the judgment of the Court of Appeals of Franklin County, Ohio, upholding the constitutionality of Ohio Revised Code § 5735.145.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

79a

Respectfully submitted,

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## CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing has been served by regular United States mail, first-class, postage prepaid, upon Richard C. Farrin, Assistant Attorney General, 30 East Broad Street, Columbus, Ohio 43215; David C. Crago, Esq., 1900 Huntington Center, 41 South High Street, Columbus, Ohio 43215; and Patricia M. Wilson, Esq., 539 South Main Street, Findlay, Ohio 45480 on this 9th day of October, 1987. All parties required to be served have been served.

/s/ David J. Young  
DAVID J. YOUNG

No. 87-654

Supreme Court, U.S.  
**F I L E D**

**NOV 20 1987**

JOSEPH F. SPANIOL, JR.  
CLERK

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**IN THE SUPREME COURT OF THE UNITED STATES**

**October Term, 1987**

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**NEW ENERGY COMPANY OF INDIANA,**

*Appellant,*

v.

**JOANNE LIMBACH, et al.,**

*Appellees.*

---

**On Appeal from the Supreme Court of Ohio**

---

**MOTION OF APPELLEE SOUTH POINT ETHANOL  
TO AFFIRM OR DISMISS**

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3697

### **QUESTION PRESENTED**

Whether an Ohio statute violates the Commerce Clause by providing that a special tax incentive to fuel dealers designed to encourage the production and use of ethanol in Ohio and other states is inapplicable to fuel containing ethanol produced in a state that does not provide a similar tax incentive for fuel containing ethanol produced in Ohio, despite the statute's lack of either a protectionist purpose or a detrimental effect on interstate commerce.

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**NO. 87-654**

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**IN THE SUPREME COURT OF THE UNITED STATES**

**October Term, 1987**

---

**NEW ENERGY COMPANY OF INDIANA,**

*Appellant,*

**v.**

**JOANNE LIMBACH, et al.,**

*Appellees.*

---

**ON APPEAL FROM THE SUPREME COURT OF OHIO**

---

**MOTION OF APPELLEE SOUTH POINT ETHANOL  
TO AFFIRM OR DISMISS**

At issue on this appeal is the validity of Ohio Rev. Code § 5735.145(B), which provides that a special tax incentive to fuel dealers designed to encourage the production and use of ethanol in Ohio and other states is inapplicable to fuel containing ethanol produced in a state that does not provide a similar tax incentive for ethanol produced in Ohio. Appellant New Energy Company of Indiana ("New Energy") has abandoned challenges grounded on the Privileges and Immunities and Equal Protection Clauses of the United States Constitution and appeals only on the theory that Ohio Rev. Code § 5735.145(B) offends the Commerce Clause, U.S. Const. art. I, § 8, cl. 2. The Ohio courts properly rejected this theory, and New Energy has presented this Court with no issue warranting plenary review. Accordingly, the decision of the Supreme Court of Ohio should be summarily affirmed or, in the alternative, the appeal should be dismissed.

**STATEMENT OF THE CASE**

Among the many environmental and economic benefits associated with ethanol use, perhaps the most significant is a

reduction in toxic emissions from leaded automobile fuels, which the Environmental Protection Agency has deemed a serious public health problem. 49 Fed. Reg. 31,036 (1984). Lead is toxic to preschool and unborn children and has been linked to high blood pressure in adults. 50 Fed. Reg. 9401 (1985). Gasoline is "the most ubiquitous source of lead emission in the environment." 49 Fed. Reg. at 31,038. Because its octane-enhancing abilities enable it to replace lead in gasoline, ethanol is the most promising motor vehicle fuel additive today. Amended Agreed Findings of Fact ("Finding") 10, South Point App. 3a. Despite assertions to the contrary in its Jurisdictional Statement, New Energy itself has conceded that ethanol is the most cost-effective and environmentally benign replacement for lead in gasoline. *Id.*

Because of the substantial benefits associated with the use of ethanol as a motor vehicle fuel additive, the federal government and many states have initiated programs to make viable its production and use. Findings 10, 11, 13, New Energy Finding 11, South Point App. 3a-4a, 7a. The most effective of these programs have involved tax credits, which have been employed by the federal government and at least thirty-two states to make ethanol production and use possible. Finding 11, New Energy Finding 11, South Point App. 3a, 7a. These incentives are, for all practical purposes, responsible for the present existence of substantial interstate commerce in ethanol. New Energy's chief executive officer testified at trial that, due to the high cost of producing ethanol, absent federal and state incentives "ethanol would not be a viable factor in the market place today." Mar. 1 Hg. 17.<sup>1</sup>

Joining the federal government and many other states, Ohio has recognized the benefits associated with ethanol use and has used tax incentives to subsidize the development and growth of interstate commerce in ethanol. Finding 13, South Point App. 3a-4a. Although it could have chosen (as did New Energy's

<sup>1</sup> Evidence from the March 1, 1985 and March 29, 1985 trial court hearings in the case will be referenced as "Mar. 1 Hg. \_\_\_\_" and "Mar. 29 Hg. \_\_\_\_," as in New Energy's Jurisdictional Statement.

state, Indiana) to encourage the in-state production of ethanol by means of a direct subsidy available only to Ohio ethanol producers, Ohio's General Assembly has attached such value to the use of ethanol that it has been willing to indirectly subsidize both in-state and out-of-state ethanol producers.

This appeal arises from the fact that Ohio's willingness to subsidize out-of-state ethanol producers has not been completely unlimited; that willingness has instead been conditioned on the availability in those producers' states of a similar indirect subsidy for Ohio-produced ethanol, a limit which was intended, among other things, to provide an incentive to other states to enact ethanol tax credits and which is fully consistent with the goal of stimulating ethanol production and use on a national basis. New Energy Finding 21, South Point App. 8a.

The Ohio ethanol credit is tied to a fuel tax that Ohio imposes on retail dealers for each gallon of gasoline sold in the state. Ohio Rev. Code §§ 5735.01-5735.99. Under Ohio Rev. Code § 5735.145, fuel dealers are granted a credit toward this tax of 2.5¢ per gallon for the sale of gasoline that is blended with not more than ten percent ethanol. This credit is available for gasoline blended with ethanol ("gasohol") produced in Ohio or in any other state, unless the state of origin does not grant "an exemption, credit or refund from such state's motor vehicle fuel excise tax or sales tax for similar fuel containing ethanol produced in Ohio." Ohio Rev. Code § 5735.145(B).<sup>2</sup>

Ethanol produced in numerous other states is eligible for Ohio's special tax incentive, and an abundance of ethanol produced outside of Ohio is available to Ohio retailers. Finding 17, South Point App. 5a. Of the midwestern states, Ohio, Kentucky, Tennessee, Iowa, Illinois and Minnesota all provide tax incentives for gasohol sales. The only ethanol producer with

<sup>2</sup> New Energy states in the Questions Presented section of its Jurisdictional Statement that the Ohio statute denies a credit for ethanol produced out of state unless the producer state grants "at least as high" a credit there for Ohio-produced ethanol. Jurisdictional Statement at ii. This is untrue. The Ohio statute provides a credit for ethanol produced in all states granting a reciprocal tax credit in any amount. Ohio Rev. Code § 5735.145(B).

an Ohio production facility is Appellee South Point Ethanol ("South Point").<sup>3</sup> Out-of-state ethanol producers who sell to Ohio dealers include Archer Daniels Midland ("ADM"), Pekin Energy ("Pekin"), and A.E. Staley ("Staley"). ADM, the largest producer of ethanol in the United States, and Pekin have production facilities in Illinois. Staley has production facilities in Tennessee. Ohio dealers selling gasoline blended with ethanol produced by ADM, Pekin, or Staley in Illinois or Tennessee, as well as with ethanol produced by South Point, are entitled to the Ohio ethanol tax credit. *Id.*

Ethanol produced in Indiana by New Energy, however, does not qualify for the Ohio tax incentive under Ohio Rev. Code § 5735.145(B) because Indiana decided in 1984 to limit its support of ethanol production to ethanol produced in Indiana. In implementing this decision, Indiana eliminated its ethanol tax credit, which was available for ethanol produced in other states as well as in Indiana, and replaced it with a direct subsidy available only to Indiana ethanol producers — the only one of which was New Energy.<sup>4</sup> As a result, ethanol produced by New Energy, which has been directly subsidized by Indiana, no longer qualifies for Ohio's ethanol tax credit, and New Energy's ethanol is thus less attractive to Ohio fuel dealers than ethanol produced in states like Illinois and Tennessee and in Ohio.

3. South Point is an Ohio partnership. A Sup. Ct. R. 28.1 listing of corporate affiliations is therefore not provided.

4. Before the Fall of 1984 when New Energy began to compete in the ethanol market, Indiana encouraged the use of ethanol by applying a lower tax rate to all retail gasoline sales than the rate for retail gasoline sales. In anticipation of New Energy's entry into the market, however, in March 1984 the Indiana legislature repealed the lower tax rate for ethanol, effective July 1, 1985, and, in the same bill, replaced this lower tax rate with the Ethanol Fuel Production Incentive Grant, which is in effect a production credit available only to New Energy. Mar. 1 Hg. 20-22; Mar. 29 Hg. 8-9. Following the trial in this case, Indiana law was amended to retain only 1¢ per gallon of ethanol blend credit. With the combination of the Indiana production grant (1.5¢ per blend gallon) and the Ohio credit (1¢ per blend gallon), New Energy was in fact not at a competitive disadvantage with South Point. These grants have since been discontinued in Indiana.

The trial court found that the unavailability of the Ohio tax credit will cause severe financial hardship to New Energy. Finding 20, New Energy Finding 20, South Point App. 5a, 8a. But Ohio Rev. Code § 5735.145(B) does not preclude New Energy from selling ethanol in Ohio. It merely affects the price New Energy must charge in Ohio for its product in order to compete effectively for Ohio business with other ethanol producers (only one of which is located in Ohio). Finding 18, South Point App. 5a.

To the extent that Ohio's unwillingness to subsidize New Energy's ethanol production makes it uneconomical for New Energy to sell its ethanol in Ohio (a point on which the trial court made no finding but merely stated New Energy's view, *see id.*), no burden is imposed on interstate commerce. Two compelling reasons support this conclusion.

First, New Energy's assertion that it cannot profitably market ethanol in Ohio absent a state tax incentive translates directly into a conclusion that without the tax incentive there would be *no* commerce in ethanol. Mar. 1 Hg. 17. Ohio's tax incentive may not be as broad as New Energy would like, but New Energy's own contention, if true, clearly demonstrates that the Ohio incentive actually *encourages* the flow of interstate commerce. Second, the trial court found that ethanol producers from states other than Ohio, which are eligible for Ohio's tax incentive, could supply the portion of the Ohio ethanol market that New Energy had been supplying before the enactment of Ohio Rev. Code § 5735.145(B). Finding 17, South Point App. 5a. Although Ohio Rev. Code § 5735.145(B) may have the effect of reducing New Energy's market share for ethanol in Ohio, New Energy presented no evidence that the statute was protectionist in its purpose or effect or that it would in any way affect the mix of in-state and out-of-state ethanol sold in Ohio or reduce the flow of ethanol into Ohio from other states.

## ARGUMENT

New Energy's attack on the reciprocity provision of Ohio Rev. Code § 5735.145(B) wholly ignores the manner in which the challenged provision operates and relies instead on a hodge-podge of general principles applied with little or no analysis. Distilled to its essence, that attack rests on no more than the erroneous assumption that reciprocity provisions are invalid per se, regardless of their impact, or lack of impact, on interstate commerce. That assumption cannot withstand scrutiny, and New Energy's proof at trial and arguments on appeal provide no alternative basis for invalidating Ohio Rev. Code § 5735.145(B).

### I. The Statutory Limit On Ohio's Willingness To Subsidize The Growth And Development Of Interstate Commerce In Ethanol Is Fully Consistent With This Court's Reciprocity Decisions.

One of the numerous purposes supporting the enactment of Ohio Rev. Code § 5735.145(B)<sup>5</sup> was to promote domestic industry by influencing other states to enact similar tax incentives to encourage the use of ethanol. New Energy App. 63a (trial court opinion). The Ohio legislature chose to further this purpose by creating a tax incentive to stimulate the development and nationwide expansion of a market that would not otherwise have existed. Mar. 1 Hg. 17. Because the ethanol market owes its existence to incentives such as the Ohio tax credit, this case raises very different issues than did prior cases before this Court which involved reciprocity provisions. The Ohio statute does not, in fact, even implicate Commerce Clause

<sup>5</sup> The other purposes include: providing a cleaner and safer environment by reducing the amount of lead in gasoline, providing an outlet for the sale of corn surpluses, creating a savings in federal farm and agricultural programs, boosting rural economies and decreasing U.S. dependence on foreign oil. Findings 1, 10, South Point App. 1a, 3a; Mar. 1 Hg. 8-9, 12-13. In this Motion to Affirm or Dismiss, South Point has focused on the purpose of promoting domestic industry by influencing other states because it is this purpose that New Energy has attacked. Jurisdictional Statement at 13-18.

concerns because, rather than obstructing the natural flow of interstate commerce, the statute actually *creates* an interstate market. It surely should be constitutional for a state to enact such legislation that reflects the very principles the Commerce Clause was enacted to protect.

Although they were decided under the Equal Protection Clause, this Court's recent decisions in *Metropolitan Life Insurance Co. v. Ward*, 470 U.S. 869 (1985), and *Western & Southern Life Insurance Co. v. State Board of Equalization*, 451 U.S. 648 (1981), shed substantial light on this case. Both *Ward* and *Western & Southern* involved discriminatory state taxes imposed on insurance companies, and together they stand for the proposition that promoting the *in-state* business of domestic companies by penalizing foreign companies who also want to do business in the state is not a legitimate state purpose, but that promoting the *interstate* business of domestic companies by deterring other states from enacting discriminatory or excessive taxes is a legitimate state purpose. *Ward*, 470 U.S. at 876-878; *Western & Southern*, 451 U.S. at 671. As the Court noted in *Ward*, whether a state's promotion of local industry is a valid purpose under the Commerce Clause (as opposed to the Equal Protection Clause) depends on whether that purpose implicates local or national interest. 470 U.S. at 876 n. 6.

Ohio's ethanol tax incentive is designed to encourage the use of ethanol in Ohio and thus to spur its production in Ohio and elsewhere. It applies to both foreign and domestic ethanol and is not intended to provide an advantage to Ohio ethanol producers at the expense of foreign ethanol producers who compete for the business of Ohio fuel dealers. The reciprocity limitation on the Ohio tax incentive does not affect the legitimacy of Ohio's objective. That limitation is not intended to increase Ohio producers' share of the Ohio ethanol market, but to encourage other states to provide similar incentives, one effect of which is to enable Ohio producers to market their product in other states.

Here, as California did in *Western & Southern*, Ohio has attempted to influence the policies of other states in order to

promote the production and use of ethanol on a national basis and to "enhance its domestic companies' ability to operate interstate." *Ward*, 470 U.S. at 878. Ohio has not, as Alabama did in *Ward*, "erected barriers to foreign companies who wish to do interstate business in order to improve its domestic [companies'] ability to compete at home." *Id.*

Under the standard established in *Ward* and *Western & Southern*, therefore, the objectives underlying Ohio Rev. Code § 5735.145(B) are perfectly legitimate.<sup>6</sup> The manner in which Ohio has pursued its objective of promoting the production and use of ethanol is equally legitimate.

New Energy speaks in sweeping and general terms of Ohio's "discrimination" against businesses from another state, but never identifies any barrier to interstate commerce created by Ohio Rev. Code § 5735.145(B). The reason for this absence of proof is clear: the challenged statute imposes no such barrier and does not prevent or impede the movement of ethanol in interstate commerce. The premise of New Energy's argument on this appeal is not that Ohio has created some *artificial barrier* to interstate commerce in ethanol, but rather that the Commerce

6 Appellant attacks the legitimacy of Ohio's purpose of encouraging other states to enact similar ethanol tax credits, citing *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511 (1935) and *Brown-Forman Distillers Corp. v. New York State Liquor Authority*, 476 U.S. 573 (1986). Ohio has only attempted to encourage other states, however, not to regulate outside its borders as was the case in *Baldwin* and *Brown-Forman*. In *Baldwin*, the New York legislature prohibited in-state sales of milk bought outside of New York unless the price paid to the out-of-state producer was no lower than the minimum price payable to New York producers. This Court held that New York's indirect regulation of prices paid in other states to producers located there unduly burdened interstate commerce. *Baldwin*, 294 U.S. at 524. Similarly, in *Brown-Forman* a New York law prohibited the wholesale sale of liquor at prices any higher than the lowest price that seller would charge for its product elsewhere in the United States during the same month. The Court held that this attempt to "project its legislation into [other States] by regulating the price to be paid for liquor in those States" violated the Commerce Clause. *Brown-Forman*, 106 S. Ct. 2080, 2086 (quoting *Baldwin*, 294 U.S. at 521). Attempting to influence other states, without attempting to actually legislate extraterritorially as New York did in *Baldwin* and *Brown-Forman*, is an entirely legitimate state purpose. *Western & Southern*, 451 U.S. at 671.

Clause has been violated because the *artificial incentive* to such commerce embodied in Ohio's ethanol tax credit has not been extended to ethanol produced by New Energy.

The federal government and many states have recognized the benefits of using ethanol as a motor vehicle fuel additive. Finding 11, New Energy Finding 11, South Point App. 3a, 7a. Many of those benefits, however, are noneconomic in nature. The development of interstate commerce in ethanol has thus required an extensive governmental commitment. In Ohio, as in many other states, that commitment has taken the form of a tax incentive to users of ethanol. New Energy's chief executive officer testified that the company would be unable profitably to market ethanol in Ohio absent the tax credit because the price that New Energy would receive would be too low in relation to its production costs. Mar. 1 Hg. 17. In other words, without the Ohio tax credit there would be no market for, or commerce in, ethanol in Ohio, no matter where the ethanol was produced. As a result, this case cannot be characterized as one in which "the State interfered with the natural functioning of the interstate market either through prohibition or through burdensome regulation." *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 806 (1976).

This fact clearly distinguishes the reciprocity decisions on which New Energy relies. In *Great Atlantic and Pacific Tea Co. v. Cottrell*, 424 U.S. 366 (1976) ("A & P"), for example, Mississippi banned the sale of all milk from other states unless the producer state accepted Grade A milk from Mississippi. In striking down this reciprocity clause, the Court found that it had a "devastating effect upon the free flow of interstate milk," *id.* at 375, and did not serve any legitimate interest of the state. Similarly, in *Sporhase v. Nebraska ex rel. Douglas*, 458 U.S. 941 (1982), Nebraska banned the withdrawal of ground water intended for use in any adjoining state unless that state granted reciprocal rights for the use of its water in Nebraska. This reciprocity provision, which did not significantly advance any legitimate state interest, *id.* at 958, "operate[d] as an explicit barrier to commerce between" Nebraska and Colorado, *id.* at

957, and prevented commerce in water that otherwise would have occurred.

This case presents facts far different from those in *A & P* and *Sporhase*.<sup>7</sup> In each of those cases, the challenged reciprocity provision burdened interstate commerce by preventing or drastically reducing the flow of goods across state lines. The same cannot be said here, in light of New Energy's admission that there would be no commerce in ethanol in Ohio absent the Ohio tax incentive. Because it provides a tax incentive to all out-of-state ethanol except ethanol from states lacking similar incentives, the Ohio statute is a narrowly tailored means to encourage free trade among the states. The statute invites cooperation, not retaliation, from other states. Invalidation of Ohio Rev. Code § 5735.145(B) would require a conclusion that the Commerce Clause prohibits a state that has decided to use its tax laws to make economically viable a product for which there would otherwise be no market from structuring its tax incentive in such a way as to encourage other states to provide similar incentives. Commerce Clause jurisprudence simply does not support this result.

On that score, the instant case bears a strong resemblance to *Hughes v. Alexandria Scrap Corp.*, *supra*, which rejected a Commerce Clause challenge to a Maryland statute offering a state bounty on inoperable automobile hulks which had the effect of disadvantaging *all* out-of-state scrap processors in relation to in-state processors. The case was decided on the ground that the state was acting as a market participant, but Justice Powell observed in dicta in his majority opinion, in language highly applicable to the Ohio ethanol tax incentive,

that the commerce affected by the 1974 amendment appears to have been created, in whole or in substantial part, by the Maryland bounty scheme. We would hesitate to hold that the Commerce Clause forbids

<sup>7</sup> Another contrast between Ohio Rev. Code § 5735.145(B) and the statutes in *A & P* and *Sporhase* is that the Ohio statute does not absolutely ban the sale of out-of-state ethanol; it merely denies a partial tax credit to the retailers who purchase such ethanol.

state action reducing or eliminating a flow of commerce dependent for its existence upon state subsidy instead of private market forces.

426 U.S. at 809 n.18.

Justice Stevens' concurring opinion in *Hughes* explained this elemental concept more fully:

It is important to differentiate between commerce which flourishes in a free market and commerce which owes its existence to a state subsidy program. Our cases finding that a state regulation constitutes an impermissible burden on interstate commerce all dealt with restrictions that adversely affected the operation of a free market. This case is unique because the commerce which Maryland has "burdened" is commerce which would not exist if Maryland had not decided to subsidize a portion of the automobile scrap-processing business.

*Id.* at 815;<sup>8</sup> see also Regan, *The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause*, 84 Mich. L. Rev. 1091, 1196 nn. 202, 203 (1986).

Viewed in this way, Ohio Rev. Code § 5735.145(B) does not impose any burden on interstate commerce. Ohio has created a tax incentive — applicable to both in-state and out-of-state ethanol — to encourage the production and use of ethanol. By so doing, it has given rise to commerce that "would not exist" without the incentive. Just as Ohio could not be criticized under the Commerce Clause for failing to create that commerce in the first instance, *Hughes*, 426 U.S. at 815-816 (Stevens, J., concurring), the State cannot be said to have burdened commerce by experimenting with a limit on the availability of its tax incentive in order to induce other states to create similar incentives. *Id.* at 817.

<sup>8</sup> Justice Stevens noted that the result would not differ had the market been merely small rather than nonexistent before the bounty scheme was enacted: "the analysis is the same whether we are dealing with the newly created portion of a pre-existing market or with an entirely new market." *Id.*

The Commerce Clause limits the power of states "to erect barriers against interstate trade." *Lewis v. BT Investment Managers, Inc.*, 447 U.S. 27, 35 (1980); see also *Hughes*, 426 U.S. at 807. Allowing the states to encourage the development and expansion of a national market for an admittedly beneficial product that would otherwise have no market serves the very same interests in maintaining interstate trade that the Commerce Clause was meant to protect. Ohio Rev. Code § 5735.145(B) does not violate the Commerce Clause. On the contrary, it was enacted for a legitimate state purpose that is entirely consistent with those constitutional protections.

## II. Ohio Rev. Code § 5735.145(B) Does Not Protect Local Producers At The Expense Of Interstate Commerce.

The Ohio Supreme Court correctly focused on the ultimate issue in this case: whether the statute had as its purpose economic protectionism. This Court has consistently prohibited states from favoring local producers at the expense of interstate commerce. See, e.g., *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984); *Hunt v. Washington State Apple Advertising Commission*, 432 U.S. 333 (1977); see generally *Regan, supra*. As the Supreme Court of Ohio properly found, however, Ohio Rev. Code § 5735.145(B) is not protectionist in either its purpose or effect. *New Energy Co. v. Limbach*, 32 Ohio St. 3d 206, 207 (1987), *New Energy App.* 4a.

If the Ohio legislature had wanted to protect Ohio ethanol producers such as South Point, Ohio Rev. Code § 5735.145(B) was a highly impractical means to achieve that purpose. A more effective means would have been to directly subsidize in-state producers, as did Indiana. Ohio instead enacted a tax credit that applies not only to in-state producers but also to producers from numerous other states, including Illinois, home of the nation's largest ethanol producer. The Ohio legislation did not insulate Ohio producers from competition with interstate competitors from these states. On the contrary, the statute has encouraged out-of-state producers from such states to participate in the Ohio market.

The presence of this vigorous interstate competition for Ohio business contrasts sharply with the situation in the cases cited by New Energy. For its argument that discriminatory laws impermissibly burden interstate commerce, New Energy principally relies upon *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318 (1977); *Bacchus Imports, supra*; *Armco, Inc. v. Hardesty*, 467 U.S. 638 (1984); and *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388 (1984). In each of these cases, the statute at issue treated all out-of-state competitors differently from local competitors with the result that the "home team" received economic advantages unavailable to any outsider.

For example, in *Boston Stock Exchange* the state imposed a tax on all out-of-state stock transfers but not on in-state transactions. As a result, in-state stock exchanges were totally insulated from competition by out-of-state firms. This complete protection from out-of-state competition was the determinative factor in the Court's decision:

[T]he fundamental principle that we find dispositive of the case now before us [is]:

No State may, consistent with the Commerce Clause, "impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business."

*Boston Stock Exchange*, 429 U.S. at 329.

This dispositive factor of protectionism is totally absent from the present case.<sup>9</sup> Ohio Rev. Code § 5735.145(B) does not treat the interstate market differently from the intrastate market. As a result, the "home team" receives no advantage at the expense of all "outsiders." There is simply no discrimination against interstate commerce for the protection of a domestic producer.

<sup>9</sup> The same distinction can be drawn with the other cases relied upon by New Energy. See, e.g., *Bacchus Imports*, 468 U.S. at 271-272; *Armco*, 467 U.S. at 642; *Westinghouse*, 466 U.S. at 398.

The facts adduced at trial clearly showed that all interstate competitors in the Ohio market, except New Energy, received the Ohio credit. Finding 17, South Point App. 5a. Further, it is undisputed that these interstate competitors were ready, willing and able to supply New Energy's portion of the Ohio ethanol market, if New Energy removed itself from this market. *Id.* New Energy cannot escape the total absence of proof of discrimination against interstate commerce by simply asserting that such discrimination exists. The courts below properly concluded that Ohio Rev. Code § 5735.145(B) does not discriminate against interstate commerce and does not represent the type of economic protectionism that violates the Commerce Clause.

### III. New Energy Failed To Prove At Trial That The Statute Imposes A Burden On Interstate Commerce.

At every level of appeal of this case, New Energy has been unable to surmount the barrier of its failure to prove — or even to present any evidence — at trial that the Ohio statute imposes a burden on interstate commerce. Instead, New Energy merely asserts that the reciprocity provision “discriminates” against interstate commerce, and asks this Court to declare the statute unconstitutional without any supporting evidence. In fact, New Energy purposely created a situation where the courts could only speculate as to the existence of any burden that might result from the statute, by seeking trial on an expedited basis rather than waiting to see what the actual impact of the statute would be. New Energy then asked the courts to ignore long-established principles of constitutional decision-making and declare that the statute unconstitutionally burdens interstate commerce based purely upon speculation, rather than evidence.

This Court has traditionally applied two separate tests for measuring the states' compliance with the Commerce Clause:

where simple economic protectionism is effected by state legislation, a virtually per se rule of invalidity has been erected.

\*\*\*\*

But where other legislative objectives are credibly advanced and there is no patent discrimination against interstate trade, the Court has adopted a much more flexible approach, the general contours of which were outlined in *Pike v. Bruce Church, Inc.*

*Philadelphia v. New Jersey*, 437 U.S. 617, 624 (1978). Because the Ohio statute benefits numerous out-of-state producers to the same extent that it benefits Ohio producers, the Supreme Court of Ohio properly refused to use the per se standard of review. *See A & P*, 424 U.S. at 371-372. In other cases involving reciprocity statutes, this Court has rejected the per se standard of review and instead applied the balancing test first articulated in *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970): when the statute “effectuate[s] a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.” *See A & P*, 424 U.S. at 371-372. The party challenging a statute under the Commerce Clause has the burden of establishing that the statute imposes a burden on interstate commerce. *See, e.g., Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, *reh'g denied sub nom. Shell Oil Co. v. Governor of Maryland*, 439 U.S. 884 (1978).

To warrant invalidation of Ohio Rev. Code § 5735.145(B) under the Commerce Clause, then, New Energy has the burden to prove — not hypothetically, but with substantive evidence — that (1) the provision imposes a burden on interstate commerce, and (2) the burden imposed clearly outweighs any legitimate state interest advanced in support of the statute. The record below and the findings of the trial court establish that New Energy failed to meet its burden of proof on these issues.<sup>10</sup>

This Court has rejected the premise “that every action by a State that has the effect of reducing in some manner the flow of

<sup>10</sup> Because New Energy failed to offer any evidence of a burden on interstate commerce, this Court need not analyze the extent of any such burden in relation to the purposes supporting the statute. *See Pike*, 397 U.S. at 142.

goods in interstate commerce" constitutes an impermissible burden under the Commerce Clause. *Hughes* 426 U.S. at 805. Because the Ohio ethanol tax incentive actually creates a market in interstate commerce for a product that would not otherwise be traded, it is inapposite to even characterize the statute as imposing a "burden" upon commerce at all. *Id.* In such circumstances, where the state has no obligation to create the market and certainly none to subsidize out-of-state businesses, "[w]hether the encouragement takes the form of a cash subsidy, a tax credit or a special privilege intended to attract investment capital, it should not be characterized as a 'burden' on commerce." *Id.* at 816 (Stevens, J., concurring). Even where the incentive is not available to all out-of-state potential market participants, the "burden" caused by nonreceipt of the benefit is not the type of burden that implicates the Commerce Clause. *Id.* at 816-817.

Even if Ohio Rev. Code § 5735.145(B) could be characterized in the abstract as creating a burden on the interstate market, New Energy has failed to prove the existence of any such burden. Instead, New Energy has focused only on the potential impact of the statute on New Energy's own business. This Court has stated, however, that "[t]he fact that the burden of a state regulation falls on some interstate companies does not, by itself, establish a claim of discrimination against interstate commerce." *Exxon*, 437 U.S. at 126; see also *CTS Corp. v. Dynamic Corp. of America*, 107 S. Ct. 1637, 1649 (1987). The challenged statute in *Exxon* prohibited a producer or refiner of petroleum products from operating any retail service station within the state of Maryland. The plaintiff in *Exxon* complained that the statute would require it to stop selling its product in Maryland. The Court concluded, however, that the plaintiff's withdrawal from the market would not warrant:

... a finding that the statute impermissibly burdened interstate commerce.

Some refiners may choose to withdraw entirely from the Maryland market, but there is no reason to assume that their share of the entire supply will not be promptly replaced by other interstate refiners. The source of the consumers' supply may switch from company-operated stations to independent dealers, but interstate commerce is not subjected to an impermissible burden simply because an otherwise valid regulation causes some business to shift from one interstate supplier to another.

*Exxon*, 437 U.S. at 126-127. In other words, the Commerce Clause is concerned with the impact of a statute on the total flow of interstate commerce from all sources rather than the potential impact upon a single company. *Id.* at 126 n.16; *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 474, *reh'g denied* 450 U.S. 1027 (1981).

This analysis of the Commerce Clause does not mean that a state may arbitrarily discriminate against a particular business. Rather, it recognizes that the protection of specific firms stems from the Equal Protection Clause, not the Commerce Clause. As this Court recently explained: "The two constitutional provisions perform different functions in the analysis of the permissible scope of a State's power — one protects interstate commerce, and the other protects persons from unconstitutional discrimination by the States." *Ward*, 470 U.S. at 881 (footnote omitted).

New Energy initially brought its claim under the Equal Protection Clause as well as the Commerce Clause. After this Court announced its decision in *Ward*, however, New Energy withdrew its Equal Protection claim. New Energy now attempts to base its Commerce Clause claim on proof that, at best, goes to the Equal Protection question rather than the issue of a burden upon interstate commerce taken as a whole.

The only evidence in the record regarding the impact of the statute related to its potential effect on New Energy. There was no evidence of any burden on any other out-of-state producer of

ethanol or on the general flow of ethanol into Ohio from outside the state. A minimum of three out-of-state producers sell ethanol in Ohio, and have adequate capacity to replace the share of the market served by New Energy. Finding 17, South Point App. 5a. Thus, the purported "competitive disadvantage" of which New Energy complains is not limited to a comparison with merely local producers, but includes several interstate competitors as well.

New Energy has not proved that the Ohio statute imposes any burden on interstate commerce, let alone a "clearly excessive" burden. *See Pike*, 397 U.S. at 142. The lower courts correctly applied the constitutional test mandated by this Court and held, as a result, that New Energy had failed to establish its claim challenging the constitutionality of Ohio Revised Code § 5735.145(B).

### CONCLUSION

The Courts below properly held that Ohio Revised Code Section 5735.145(B) was not enacted for purposes of economic protectionism, that the Ohio legislature had a legitimate purpose for enacting the statute and that New Energy failed to prove that the statute imposed a burden upon interstate commerce. For the foregoing reasons, the Court should affirm the judgment of the Supreme Court of Ohio or, in the alternative, this appeal should be dismissed.

Respectfully submitted,

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November 20, 1987

## **APPENDIX**

IN THE COURT OF COMMON PLEAS,  
FRANKLIN COUNTY, OHIO

NEW ENERGY COMPANY :  
OF INDIANA, : Case No. 85CV-02-712  
Plaintiff,  
v. : Judge Crawford  
JOANNE LIMBACH :  
TAX COMMISSIONERS, *et al.*,  
Defendants. :

**AMENDED AGREED FINDINGS OF FACT**

The parties agree that the record in this case supports these Agreed Findings of Fact. This agreement does not waive any objection by any party as to the relevancy of any agreed fact nor does it limit any party from proposing any additional findings of fact.

1. The plaintiff, New Energy Company of Indiana ("New Energy"), is an Indiana limited partnership engaged in Commerce among the states in the business of manufacturing ethanol. The plaintiff's manufacturing facility is located in South Bend, Indiana (Tr. 5). The plaintiff is the only ethanol manufacturer with production facilities in Indiana. Ethanol produced by New Energy is presently sold to blenders in several states including Ohio, Indiana and Illinois. (Plaintiff's Exs. 1 and 2)

2. New Energy was formed in 1980 and fully capitalized in 1982 by a public offering. The equity capital invested in the entity is \$40,000,000 and the equity investors guaranteed an additional \$20,000,000 in loans to the partnership (Tr. 5).

3. The total project cost of the New Energy facility was in excess of \$185,000,000. Approximately \$150,000,000 of the project cost was funded by bank loans, the principal of which is

90% guaranteed by the United States Department of Energy pursuant to the Energy Security Act of 1980. The United States Department of Energy has also made a direct loan to New Energy in the amount of \$1,769,000 (Tr. 7).

4. The state defendants are Joanne Limbach, Tax Commissioner of the State of Ohio, and Mary Ellen Withrow, Treasurer of the State of Ohio. Together these defendants are charged with the responsibility of administering and enforcing R.C. Chapter 5735 dealing with motor vehicle fuel taxes.

5. South Point Ethanol ("South Point") intervened in this action as a defendant on March 27, 1985. South Point is a joint venture between Ashland Oil Company, the Ohio Farm Bureau, UGI and Publicker Industries which produces ethanol in Lawrence County, Ohio.

6. South Point was formed in 1981 to retrofit a closed chemical plant. Its facility is located in South Point, Ohio. The joint venturers have invested approximately \$120,000,000 in South Point. Additionally, South Point provides approximately 185 jobs and expends \$100,000,000 annually in the production of ethanol from corn.

7. The plaintiff's complaint seeks a declaration that Ohio R.C. § 5735.145(B), as amended, is unconstitutional as being violative of the United States and Ohio Constitutions. The complaint further seeks a preliminary and permanent injunction against defendants from implementing and enforcing the allegedly unconstitutional provisions.

8. Defendants answered the complaint and raised the affirmative defenses of failure to state a claim upon which relief can be granted, lack of jurisdiction over the subject matter, lack of standing to maintain the action and failure to comply with statutory requirements for commencing an action. In addition, the defendants allege that R.C. § 5703.38 prohibits the Court from granting the injunctive relief demanded by plaintiff and that plaintiff lacks standing to sue with respect to injunctive relief sought under R.C. § 2723.01.

9. Ethanol is a 199 proof alcohol. It is derived from corn which is treated with enzymes that convert the starch to sugar and ultimately into alcohol. Ethanol is mixed with gasoline in a 10/90% ratio to form a blend commonly referred to as gasohol (Tr. 14).

10. Ethanol is beneficial as a fuel additive to increase the octane rating of gasoline without contributing any additional lead into the environment. Ethanol is, in fact, the cost effective replacement for lead in gasoline and is the most environmentally benign replacement for lead. The production of ethanol also provides an outlet for the sale of corn surpluses (Tr. 9).

11. Various governmental bodies have initiated programs to encourage the production of ethanol. The United States Department of Energy provides grants for feasibility studies and guarantees 90% of certain qualifying loans (Tr. 9). To encourage the use of ethanol, the Department of Treasury exempts ethanol/gasoline blends from 6¢ of the 9¢ federal excise tax on gasoline (Tr. 9). In addition, at least thirty-two states allow credits from their respective motor fuel taxes for ethanol/gasoline blends (Tr. 10). The provision of tax credits has been the best method adopted by the Federal and state government to encourage the use of ethanol.

12. Ohio imposes a tax on dealers for each gallon of gasoline sold in Ohio. This tax is not imposed on, paid by, or collected by New Energy, South Point or any other producer of ethanol. Prior to January 1, 1985, Ohio law provided a tax credit of 35 cents per gallon for each gallon of ethanol blended with gasoline in not more than a 10% ratio and used, sold, or distributed by dealers in Ohio. This credit was available to dealers on all ethanol blends used, sold, or distributed in Ohio, regardless of where the ethanol ingredients of such blends were made (Tr. 19). (Plaintiff's Exs. 5 and 6).

13. Ohio's tax treatment of ethanol containing products was altered by the enactment of R.C. § 5735.145(B) which limits the availability of the credit to Ohio produced ethanol and ethanol produced in states which grant similar credits to

ethanol produced in Ohio and sold within that state (Tr. 23). The newly enacted R.C. § 5735.145(B) provides that:

The qualified fuel otherwise eligible for the qualified fuel credit shall not contain ethanol produced outside Ohio unless the Tax Commissioner determines that the fuel claimed to be eligible for credit contains ethanol produced in a state that also grants an exemption, credit or refund from such state's motor vehicle fuel excise tax or sales tax for similar fuel containing ethanol produced in Ohio; provided however, that such credit shall not exceed the amount of the credit allowable for qualified fuel containing ethanol produced in Ohio.

Prior to the adoption of R.C. § 5735.145(B) representatives of South Point testified before the House Ways and Means Committee of the Ohio General Assembly regarding all of the benefits of the use of ethanol, including, among other things, the public health benefits of its use as a substitute for lead as an octane enhancement in gasoline.

14. But for the enactment and operation of R.C. § 5735.145(B) plaintiff would receive identical tax treatment by the Ohio authorities as that accorded to any other Ohio dealer or producer of ethanol. The validity or invalidity of subsection (B) does not affect any other provision of or the application of R.C. § 5735.145.

15. The tax credit provided for in R.C. § 5735.145(B) has been applied in the manner provided by R.C. Chapter 5735 on the ethanol sold by plaintiff in Ohio during January and February of 1985 (Tr. 25). (Plaintiff's Exs. 3 and 4).

16. The impact of the application of R.C. § 5735.145 is being felt by the plaintiff on a graduated basis during the period of January 1, 1985 through July 1, 1985. Dealers of gasohol containing ethanol produced by the plaintiff received the full 25¢ a gallon credit available to retailers on spot sales in Ohio during January and February of 1985 (Tr. 19). Prior to January 1, 1985 the credit available to dealers of gasohol containing ethanol was 35¢ per gallon (Tr. 19). The credit applicable to

dealers of gasohol containing ethanol produced by the plaintiff is recalculated monthly by the Ohio Department of Taxation (Tr. 24). During the month of March the credit was 24¢ per gallon. By July 1, 1985 R.C. § 5735.145(B) is fully applicable to all sales of ethanol by the plaintiff including both spot sales and contract sales (Tr. 23-24). After July 1, 1985 Ohio dealers of gasohol containing ethanol produced by the plaintiff will not receive any credit while retailers selling gasohol blended with non-Indiana ethanol will continue to receive 25¢ per gallon credit (Tr. 23). (Plaintiff's Exs. 7).

17. New Energy and South Point compete for the sale of ethanol to Ohio dealers with Archer Daniels Midland ("ADM"), Pekin Energy ("Pekin") and A.E. Staley ("Staley"). ADM and Pekin have production facilities in Illinois; Staley had production facilities in Tennessee. Ethanol produced in these facilities is entitled to the full Ohio credit. Additionally, ADM, Pekin and Staley have the capacity to supply the portion of the Ohio market for ethanol presently being filled by the plaintiff.

18. The evidence showed that the decreased credits afforded to retailers of blended gasoline containing plaintiff's product for January and February of 1985 decreased the price paid to plaintiff for its product (Tr. 27). (Plaintiff's Ex. 6) The decreased credits will continue to affect the price paid to plaintiff for its product through July 1, 1985. After July 1, 1985, the plaintiff believes that the application of R.C. § 5735.145(B) will affect the price paid to plaintiff for its product to the extent that the plaintiff will be unable to sell its ethanol in Ohio (Tr. 23).

19. The amount of state tax credit available to dealers of ethanol on a gallon of ethanol directly affects the per gallon price that dealers pay to ethanol producers in that the lower the available credit, the lower the price paid to ethanol producers for a gallon of ethanol (Tr. 28-29).

20. The continued enforcement of R.C. § 5735.145(B) will cause financial hardship to plaintiff.

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IN THE COURT OF COMMON PLEAS,  
FRANKLIN COUNTY, OHIO

NEW ENERGY COMPANY )  
OF INDIANA, )

*Plaintiff,* )

v. )

JOANNE LIMBACH, )  
TAX COMMISSIONER, *et al.*, )

*Defendants.* )

Case No. 85CV-02-712

Judge Crawford

**PROPOSED ADDITIONAL FINDINGS OF FACT AND  
CONCLUSIONS OF LAW OF DEFENDANTS  
JOANNE LIMBACH, TAX COMMISSIONER OF OHIO,  
AND MARY ELLEN WITHROW, TREASURER OF OHIO**

1. It is conceivable that the Ohio General Assembly may have had several purposes in enacting R. C. § 5735.145(B), none of which were explicitly declared in the enactment itself. One of these purposes was to provide a cleaner and safer environment for Ohio citizens by encouraging the use of ethanol as a replacement for lead in gasoline not only in Ohio but in all states.

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IN THE COURT OF COMMON PLEAS,  
FRANKLIN COUNTY, OHIO

NEW ENERGY COMPANY :  
OF INDIANA, :  
Plaintiff, : Case No. 85CV-02-712  
v. : Judge Crawford  
: :  
JOANNE LIMBACH, :  
TAX COMMISSIONER, et al., :  
Defendants. :

**NEW ENERGY COMPANY OF INDIANA'S  
POST-TRIAL ADDITIONAL PROPOSED FINDINGS  
OF FACT AND CONCLUSIONS OF LAW**

Pursuant to the Court's instructions, the parties filed Agreed Findings of Fact. The plaintiff submits the following additional findings of fact which are supported by the record for review and inclusion into the Court's findings but to which the parties could not agree. The new language in prior findings is underlined.

**ADDITIONAL PROPOSED FINDINGS OF FACT**

11. Various governmental bodies have initiated programs to encourage the *production and use* of ethanol (Tr. #1, at 9). The United States Department of Energy provides loan guarantees and feasibility study grants to develop the technology to *produce* ethanol more efficiently (Tr. #1, at 9). To encourage the *production and use* of ethanol, the Department of Treasury exempts ethanol/gasoline blends from 6¢ of the 9¢ federal excise tax on gasoline (Tr. #1, at 9-10). In addition, at least 32 states encourage the *production and use* of ethanol by allowing a credit from their respective motor fuel taxes for ethanol/gasoline blends (Tr. #1, at 10). The provision of tax credits has been the best method adopted by the federal and state governments to encourage the *production and use* of ethanol.

20. The continued enforcement of R.C. § 5735.145(B) will cause *severe* financial hardship to plaintiff and threaten plaintiff's continued viability (Tr. #1, at 44).

21. Representatives of South Point lobbied the Ohio General Assembly to enact the reciprocity provision provided for in R.C. § 5735.145(B) for the stated purpose of providing an incentive to other states to pass similar legislation (Tr. #2, at 57 and 60).

22. Intervenor raised the issue of necessary filings with the Secretary of State by the plaintiff and New Energy Corporation of Indiana, the general partner of the plaintiff. Although Ohio R.C. § 1782.49 was not effective until at least April 1, 1985, if after a review of the legal authorities cited by intervenor, plaintiff believes that the subsequent filings made by it are relevant, additional findings of fact concerning these filings (of which the Court may take judicial notice), will be presented along with the Reply Brief.

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### **CERTIFICATE OF SERVICE**

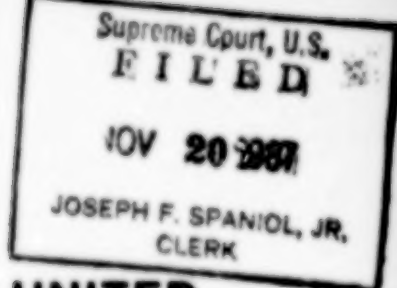
The undersigned hereby certifies that copies of the foregoing have been served by regular United States mail, first-class, postage prepaid, upon David J. Young, Esq., Murphey, Young & Smith, 250 East Broad Street, Columbus, Ohio 43215 and Herman Schwartz, Esq., 207 Myers Hall, 4400 Massachusetts Avenue, N.W., Washington, D.C. 20016, counsel for Appellant; and Richard C. Farrin, Esq., Assistant Attorney General, 30 East Broad Street, Columbus, Ohio 43215, counsel for Appellees Joanne Limbach and Mary Ellen Withrow and that all parties required to be served have been served on this 20th day of November, 1987.

---

DAVID C. CRAGO

(3)

**No. 87-654  
IN THE  
SUPREME COURT OF THE UNITED  
STATES**



**October Term, 1987**

**NEW ENERGY COMPANY OF INDIANA,**

*Appellant,*

**v.**

**JOANNE LIMBACH,**

**TAX COMMISSIONER OF OHIO, AND SOUTH POINT  
ETHANOL,**

*Appellees.*

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**ON APPEAL FROM  
THE SUPREME COURT OF OHIO  
MOTION TO DISMISS OR AFFIRM**

---

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**JOANNE LIMBACH,**

**TAX COMMISSIONER OF**

**OHIO**

## QUESTION PRESENTED

Whether R.C. 5735.145(B) which is neither an "economic protectionism" provision nor imposes an absolute ban on the sale of out-of-state ethanol in Ohio violates the Commerce Clause by allowing a tax credit for the use of out-of-state ethanol only if the state in which that ethanol is produced grants a similar credit for Ohio ethanol where such provision advances the legislative purpose of protecting the health and safety of its citizens by encouraging the use of non-polluting ethanol.

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No. 87-654

## IN THE SUPREME COURT of the UNITED STATES

October Term, 1987

NEW ENERGY COMPANY OF INDIANA,

*Appellant,*

v.

JOANNE LIMBACH,  
TAX COMMISSIONER OF OHIO, AND SOUTH POINT  
ETHANOL,

*Appellees.*

---

### On Appeal From The Supreme Court of Ohio

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### Motion to Dismiss or Affirm

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Appellee Joanne Limbach, Tax Commissioner of Ohio, moves the Court to dismiss the appeal herein or, in the alternative, to affirm the judgment of the Supreme Court of Ohio on the ground that it is manifest that the questions on which the decision of the cause depends are so unsubstantial as not to need further argument.

### STATEMENT OF FACTS

New Energy challenges the constitutionality of R.C. 5735.145(B) which was enacted as part of Am. Sub. S.B. No. 334, which became effective on January 1, 1985. New Energy argues that this reciprocity violates the Commerce Clause (Art. I, Sec. 8, cl. 3) of the United States Constitution.

The qualified fuel credit referred to in R.C. 5735.145(B) is provided by R.C. 5735.145(A) against the motor vehicle fuel tax imposed on motor vehicle fuel dealers. Such dealers are allowed a credit for each gallon of ethanol blended with gasoline in not more than a 10% ratio and used, sold or distributed by dealers in Ohio. The amount of the credit per gallon is based on a statutory formula and varies based upon changes in the federal gasohol credit. R.C. 5735.145(A)(4). The motor vehicle fuel tax is imposed upon and the ethanol tax credit is available solely to motor vehicle fuel dealers, not ethanol producers.

The ethanol tax credit is available not only for Ohio-produced ethanol which is used to create gasohol. It is also available for ethanol produced in any other state which grants similar tax incentives for ethanol use. R.C. 5735.145(B). In fact, at the time the complaint was filed and at the time the reciprocity provision was enacted ethanol produced by every out-of-state producer which competes in the Ohio market, with the sole exception of New Energy, was eligible for the full Ohio tax credit. The evidence established that these out-of-state competitors have the capacity to fully supply that portion of the Ohio ethanol market presently being filled by New Energy should New Energy withdraw from that market. There is nothing in the record to evidence that South Point Ethanol, the only Ohio producer, had the capacity to expand into any void in the Ohio market. The Ohio Court of Appeals found that the evidence indicates that if New Energy left the Ohio market "the primary beneficiaries would be Illinois and Tennessee producers of ethanol. . . ." (Op., at 1124). The record fully supports this finding by the Ohio Court of Appeals. One of the Illinois producers (Archer Daniels Midland "ADM") is the largest and most aggressive producer and it has the full capacity to fill any void in the Ohio market.

Unlike New Energy's assertions which are based solely on assumptions and speculation, the finding of the Ohio Court of Appeals was based on record evidence.

The use of leaded gasoline in motor vehicles is one of the major contributors to air pollution in this country. It is a legitimate goal of both the federal and state governments to reduce the level of pollutants caused by the use of leaded gasoline in motor vehicles. Ethanol is the most cost-effective and environmentally benign replacement for lead in gasoline. It is not disputed that there are major health benefits to the public from replacing lead with ethanol in gasoline. New Energy stipulated to each of these facts.

One of the purposes of the Ohio General Assembly in enacting R.C. 5735.145(B) was to provide a cleaner and safer environment by encouraging the use of ethanol as a substitute for lead in gasoline not only in Ohio but in all states. The Ohio Supreme Court found that R.C. 5735.145(B) was not an "economic protectionism" measure, but rather was intended to effect this legitimate state purpose. It is undisputed that the providing of tax incentives is the best method of encouraging such use. New Energy's president so testified.

The record is devoid of any evidence supporting New Energy's repeated assertion that the sole purpose of R.C. 5735.145(B) was a parochial attempt to protect local ethanol producers against out-of-state competitors. The record fails to establish that this was either the purpose or the effect of the reciprocity provision.

## ARGUMENT

R.C. 5735.145(B) IS NOT DISCRIMINATORY IN PURPOSE OR EFFECT AND ANY INCIDENTAL BURDEN ON INTERSTATE COMMERCE IS CLEARLY OUTWEIGHED BY THE LOCAL BENEFITS TO THE HEALTH AND SAFETY OF THE PEOPLE OF OHIO ADVANCED BY THE LEGISLATION. THEREFORE, THE PROVISION DOES NOT VIOLATE THE COMMERCE CLAUSE OF THE UNITED STATES CONSTITUTION.

### 1. R.C. 5735.145(B) Is Not An "Economic Protectionism" Provision.

New Energy asserts that R.C. 5735.145(B) discriminates against interstate commerce, thereby violating the Commerce Clause of the United States Constitution. In advancing this argument, New Energy relies on Commerce Clause cases considering statutes inapposite to R.C. 5735.145(B). Because of this misplaced reliance, it is important to note at the outset what R.C. 5735.145(B) does not do. It does not grant a credit solely for Ohio-produced ethanol (unlike the statutes struck down in *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984) and *Archer Daniels Midland Co. v. State*, 315 N.W. 2d 597 (Minn. Sup. Ct. 1982) ("ADM MINN.")). It does not tax the use of ethanol differently depending solely on whether the ethanol was produced in Ohio or out of Ohio (unlike the tax provisions stricken in *Armco, Inc. V. Hardesty*, 467 U.S. 638 (1984), and *National Meat Ass'n. v. Deukmejian*, 743 F. 2d 656 (9th Cir. 1984), *aff. without opinion*, 105 S.Ct. 768 (1985)). Nor does it operate to provide a direct commercial advantage to local ethanol producers over all out-of-state producers (unlike the tax provision declared invalid in *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318 (1977)).

R.C. 5735.145(B) does not ban the sale of ethanol produced in other states from the Ohio market (unlike the statute stricken in *Philadelphia v. New Jersey*, 437 U.S. 614 (1978)), nor does it ban the sale of products manufactured in other states not having a reciprocal provision from the Ohio market (unlike the statute invalidated in *Great A & P Tea Co. v. Cottrell*, 424 U.S. 366 (1976)).

R.C. 5735.145(B) does not operate in the same manner as any of the statutes involved in any of the cases relied on by New Energy. The statute simply provides that in order for ethanol produced in another state to qualify for the credit available to motor vehicle fuel dealers who use such ethanol in creating gasohol, the state in which the ethanol is produced must also provide similar benefits for ethanol produced in other states.

In considering the Commerce Clause challenge to this enactment the Ohio courts properly rejected the urging by New Energy to expand this Court's holdings in Commerce Clause cases beyond the factual circumstances of those cases. Because each case involving a Commerce Clause challenge requires the delicate balancing of the free trade purpose of the Commerce Clause and the legitimate interests of the states, every Commerce Clause case must turn on the unique characteristics of the statute at issue and the specific facts of each case. *Boston Stock Exchange v. State Tax Commission*, *supra*, at 329.

The Commerce Clause does not stand as an absolute prohibition against all legislation having an effect on interstate commerce. New Energy's attempt to so color the Commerce Clause, and the cases decided thereunder, is belied by language in those very cases upon which New

Energy relies:

On various occasions when called upon to make the delicate adjustment between the national interest in free and open trade and the legitimate interest of the individual States in exercising their taxing powers, the Court has counseled that the result turns on the unique characteristics of the statute at issue and the particular circumstances in each case. *E.g., Freeman v. Hewitt, supra*, at 252, 91 L.Ed. 265, 67 S.Ct. 274. This case-by-case approach has left "much room for controversy and confusion and little in the way of precise guides to the States in the exercise of their indispensable power of taxation."

*Boston Stock Exchange v. State Tax Commission, supra*.

New Energy consciously avoids "the distinction established by this Court between 'protectionist' measures employed by states to favor local businesses and measures employed by states to safeguard the health and safety of their people." *National Meat Ass'n v. Deukmejian, supra*, at 659. It is only "protectionist" measures that are subject to a virtually per se rule of invalidity. Measures employed to safeguard the people of the state which have an incidental effect on interstate commerce "will be upheld unless the burden on such commerce is clearly excessive in relation to the putative local benefits." *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970).

When the chaff is removed from New Energy's Commerce Clause argument what remains is the assertion that R.C. 5735.145(B) is nothing more than simple "economic protectionism" enacted to favor local ethanol producers at

the expense of all out-of-state producers. However, New Energy was required to do more than merely assert that the statute was such a "protectionist" measure—it was required to establish this fact by the presentation of evidence. Each of the Ohio courts properly found that the enactment was not shown factually or legally to constitute "economic protectionism".

A finding that legislation constitutes nothing more than simple "economic protectionism" can be made only if it is demonstrated that it has a discriminatory purpose or a discriminatory effect. *Bacchus Imports, Ltd. v. Dias, supra*, at 270. New Energy failed to meet its burden of establishing the existence of a discriminatory purpose or effect. It presented no evidence regarding the purpose of the General Assembly in enacting R.C. 5735.145(B). It simply jumps to the conclusion that the purpose of the provision was to give a commercial advantage to local manufacturers of ethanol. This conclusion is supported neither by any evidence in the record nor by the face of the statutory provision. Based on the record and the statute, the holding of the Ohio Supreme Court that the enactment had neither a discriminatory purpose or effect is unassailable.

Unlike the Hawaiian statute struck down in *Bacchus* or the Minnesota ethanol credit stricken in *ADM Minn.*, R.C. 5735.145(B) does not grant an exemption only to a locally produced product. In *Bacchus*, it was not disputed that the sole purpose of the exemption for okolehao and pineapple wine was to encourage and promote local industry. 468 U.S., at 270-271. Neither the Hawaiian exemption nor the Minnesota credit was available to the same products produced in any other state.

R.C. 5735.145(B) cannot logically be viewed as an attempt by the Ohio General Assembly to effectuate a discriminatory purpose by providing a commercial advantage to the Ohio-produced ethanol. If that was the desire of the General Assembly, it would have enacted a provision that would restrict any tax credits solely to Ohio-produced ethanol. Rather, the General Assembly enacted R.C. 5735.145(B) which provided a credit for gasohol created with ethanol produced not only in Ohio, but in any other state which granted similar ethanol use incentives.

Because of the vigorous competition among producers involved in the Ohio ethanol market, including large out-of-state producers whose ethanol would qualify under R.C. 5735.145(B), the General Assembly was obviously aware of the fact that enactment of that provision would not give Ohio ethanol manufacturers a commercial advantage. Still, the General Assembly did enact R.C. 5735.145(B). The reason it was enacted is because it was not intended to protect Ohio producers against out-of-state competition, but rather, to effectuate a legitimate state purpose.

It is common knowledge that leaded gasoline is one of the major sources of air pollution in this country. The purpose of the Ohio General Assembly in enacting R.C. 5735.145 was to encourage the use of ethanol as a substitute for lead in gasoline. This purpose clearly advances the health and safety of the citizens of Ohio by providing a cleaner and safer environment. New Energy's repeated arguments below that no public health benefit is served by encouraging the use of ethanol as a substitute for lead in gasoline was belied by the testimony of its own president. Mr. Dierenfeld testified that he agreed "that there are major health benefits to the public from the use of ethanol incorporated in gasoline as

opposed to the lead. . . ." (R. 124), and that to encourage the use of ethanol as a substitute for lead in gasoline is a legitimate goal for both the federal and state governments. (R. 124-125). New Energy also stipulated that ethanol was the most environmentally benign replacement for lead in gasoline as well as the most cost effective (R. 20, ¶10).

New Energy attacks the wisdom of the means chosen by the Ohio General Assembly to carry out its purpose of providing a safer environment by arguing that the ethanol produced in a state without a reciprocal credit is no less desirable from a public health standpoint than ethanol produced in a reciprocating state. This misses the point of why the provision is important to the accomplishment of the goal of providing a safer environment.

The goal is not simply to encourage use of ethanol in Ohio, but to encourage its use in other states, particularly those in close geographical proximity to Ohio. Encouragement of the use of ethanol simply by dealers within Ohio would only partially advance the legislative purpose. Unless ethanol is used in other states, including the five states which border Ohio, the purpose of providing a cleaner and safer environment in Ohio would be hindered. A significant number of motor vehicles of nonresidents travel in and through Ohio every day. Additionally, even if these vehicles are not driven in Ohio, they will still pollute the atmosphere which will reach Ohio.

Unless the states in which those residents live also provide incentives for the use of ethanol, it is unlikely that they will use the more environmentally benign ethanol mixture in their vehicles. This is so because, as the testimony of New Energy's president reveals, without both state and federal incentives

ethanol producers cannot compete price-wise with gasoline. If gasohol cannot be priced equal to or less than gasoline its use will obviously suffer. It must be remembered that what is sought to be encouraged is the use of ethanol in not only Ohio but also in the other states. The mere granting of a credit for use of ethanol blended for use in Ohio will do nothing to encourage such use in other states. If the fuel dealers in other states receive no credits for using ethanol, they will not do so because they will not be able to compete with dealers selling lower cost gasoline.

Even assuming that one of the purposes of the enactment was to promote the domestic ethanol industry, that would not by itself render the enactment invalid under the Commerce Clause. This was made clear by a recent statement on the subject by this Court. In *Metropolitan Life Insurance Co. v. Ward*, 470 U.S. 869, 876-877 n.6 (1985), this Court recognized that "promotion of local industry is a legitimate state interest in the Commerce Clause context. . . ." The Court reaffirmed that "a state may enact laws pursuant to its police power that have the purpose and effect of encouraging local industry" as long as it does not "impose a discriminatory burden upon the business of other States, merely to protect and promote local business." (quoting from *Bacchus*, emphasis added) *Id.* Promotion of the local ethanol industry was clearly not the sole or primary purpose of R.C. 5735.145(B). By its basic nature a reciprocity provision is not designed only or primarily to favor domestic industry against all foreign competition. R.C. 5735.145(B) clearly does not operate in a manner that "gives the home team an advantage by burdening all foreign corporations seeking to do business within the State, no matter what they or their States do." *Id.*, at 878.

Nor has New Energy met its burden of demonstrating that the challenged provision will have a discriminatory effect by causing Ohio-produced ethanol to gain a larger share of the Ohio market at the expense of out-of-state producers. New Energy has simply relied on cases in which the statutes in issue provided credits, exemptions or lower tax rates only for in-state activity. For example, in the *ADM Minn.* case, the statute granted a tax credit only for gasohol made with ethanol distilled in Minnesota and produced by agricultural products grown in Minnesota. No reciprocity was granted to ethanol produced in a state other than Minnesota. The same is true regarding the tax exemption invalidated in *Bacchus*.

Similarly, in *National Meat Association v. Deukmejian*, *supra*, the statute taxed all out-of-state beef processors and taxed no in-state beef processors. In *Armco*, the gross receipts tax exemption was available only to local manufacturers. The tax provision struck down in *Boston Stock Exchange* imposed a higher tax on security transfers resulting from out-of-state sales than on those resulting from in-state sales. In *Pike v. Bruce Church, Inc.*, *supra*, the statute stricken required cantaloupe growers to pack their cantaloupes in Arizona.

A common thread runs through each of these cases relied on by New Energy: the statutes involved in each case provided an advantage only to local industry which resulted in a direct commercial advantage to such industry at the expense of all out-of-state competitors. This thread of unconstitutionality is not present in R.C. 5735.145(B).

R.C. 5735.145(B) does not operate on its face or in its practical effect to the disadvantage of all out-of-state ethanol

producers. It does not provide a credit for only Ohio-produced ethanol. It is available for ethanol produced in any other state of the union which provides a similar credit or exemption for the use of ethanol. This is not just an appearance of availability designed to abort a Commerce Clause challenge, it is a fact. At the time of the enactment of R.C. 5735.145(B), approximately thirty-two (32) states had some form of ethanol tax credit or exemption, including the state of Illinois where the largest producer of ethanol, ADM, is located. ADM, as well as Peking Energy, which is also located in Illinois, and A.E. Staley, which is located in Tennessee, are all competitors in the Ohio market and ethanol produced by each of these entities is entitled to the Ohio credit.

Because the tax provision involved in the cases relied on by New Energy were available only for local activities, they necessarily had a discriminatory effect against out-of-state activity. They did not operate even-handedly. Unlike those provisions, the Ohio credit is available for the use of out-of-state produced ethanol and is in fact being granted for such use. Therefore, R.C. 5735.145(B) will not necessarily cause Ohio-produced ethanol to acquire a larger share of the market and out-of-state produced ethanol to constitute a smaller share. The fact that the provision may cause a shift in the Ohio market among out-of-state producers does not cause a discrimination against interstate commerce. *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 473 (1981), and *Exxon Corp. v. Maryland*, 437 U.S. 117, 126-127 (1978).

As this Court noted in *Clover Leaf Creamery*:

We stressed that the Commerce Clause "protects the interstate market, not particular interstate firms

from prohibitive or burdensome regulations."  
(quoting from *Exxon Corp.*, 437 U.S., at 127-128).

Under the proper Commerce Clause analysis, in order to meet its burden of demonstrating a discriminatory effect, New Energy was required to establish that the statute will cause locally-produced ethanol to gain a greater share of the Ohio market and ethanol produced out-of-state to constitute a smaller share of the market. *Exxon Corp. v. Maryland*, *supra*, at 126 n.16. New Energy has failed to prove such an effect.

In fact, rather than demonstrating that the provision will have the effect of favoring the Ohio producer by causing it to gain a greater share of the market, the evidence established just the contrary. Out-of-state ethanol producers whose product is entitled to the Ohio credit when used in a qualified manner by motor vehicle fuel dealers are fully capable of supplying that portion of the Ohio market supplied by New Energy. There is nothing in the record indicating that the sole Ohio producer, South Point Ethanol, would be able to capture any new markets from these out-of-state competitors. What testimony there is indicates that ADM is the largest and most aggressive producer, from which the logical assumption would be that they would be the producer most likely to gain an increased share of the Ohio market if New Energy ceases doing business in Ohio. In fact, New Energy has not even established that the Ohio producer has the capacity to fill any void in the market. Unless it is demonstrated that South Point has the capacity to fill any new market, R.C. 5735.145(B) cannot possibly be found to have a discriminatory effect.

Having correctly determined that R.C. 5735.145(B) did not constitute "economic protectionism" but rather a measure

designed to protect the health and safety of the citizens of Ohio, the Ohio Supreme Court properly balanced the purpose of the Commerce Clause and the legitimate interest of the state in safeguarding the health and safety of its people. Given the significant benefits that will be served by encouraging the use of ethanol and the incidental effect the statute will have on interstate commerce, that Court properly upheld R.C. 5735.145(B).

**2. R.C. 5735.145(B) Does Not Impose An Absolute Ban On The Sale Of Ethanol Produced In Other States Regardless Of Whether Such States Grant Incentives To Ohio-Produced Ethanol; Therefore The Enactment Is Not Subject To The Strict Scrutiny Applied To Statutes That Impose Absolute Bans.**

The state does not dispute that in applying the Commerce Clause balancing test to determine the validity of a statute the implementation of which will result in an absolute ban on the interstate flow of a product, "[o]nly state interests of substantial importance" will save such a statute. *Great A & P Tea Co. v. Cottrell*, 424 U.S. 366, 375 (1976). Contrary to New Energy's assertion, however, whether a statute imposes an absolute ban is relevant because it is important in applying the balancing test. As the Ohio Supreme Court correctly discerned, in the absence of such a ban the statute is not subjected to the strict scrutiny standard.

It is the absence of such a ban that distinguishes R.C. 5735.145(B) from the provision stricken in *Great A & P Tea Co.*, the major case relied on by New Energy. The Mississippi provision imposed an absolute ban against the distribution of A & P's Louisiana-produced milk products in Mississippi unless Louisiana accepted Mississippi-produced milk on a

reciprocal basis. Unlike the Mississippi reciprocity provision, R.C. 5735.145(B) does not ban any product from the Ohio market. Any ethanol producer is free to sell its product to Ohio dealers. This fact distinguishes that case from the instant one, and the distinction is constitutionally significant because it directly changes the balancing test. Because R.C. 5735.145(B) does not impose an absolute ban, it is not subject to the strict scrutiny applied in *Great A & P Tea Co.*

Additionally, Mississippi's contention that its reciprocity provision served a vital state interest was found by this Court to border on the "frivolous." *Id.* at 375. While Mississippi argued that the provision maintained the State's health standards, the Court found that it in fact disserved this purpose because it would allow out-of-state milk to be distributed in Mississippi even if it was lower than Mississippi's standards as long as the state in which it was produced had entered into a reciprocity agreement with Mississippi. *Id.* In the present case, as the Ohio Supreme Court found, R.C. 5735.145(B) advances a legitimate state purpose, a healthier and safer environment.

As this Court has repeatedly recognized, each commerce Clause case requires a case-by-case analysis balancing the particular state interests involved and the interest in free trade among the states. *Boston Stock Exchange*, 429 U.S., at 329. Because the effect of the absolute ban imposed by the Mississippi statute on interstate commerce was "devastating" and the asserted state interest was found to border on the "frivolous", the balancing weighed heavily against the statute. Unlike the Mississippi statute, any incidental burden on interstate commerce resulting from R.C. 5735.145(B) is clearly outweighed by the very real health and safety benefits advanced by the provision.

The reciprocity provision stricken in *Sporhase v. Nebraska*, 458 U.S. 941 (1982), was also subjected to the "strictest scrutiny" test because it too imposed an absolute ban on the shipment of items in interstate commerce. The statute absolutely prohibited the shipment of water from Nebraska to any state which did not permit its water to be shipped to Nebraska.

Significantly, in *Sporhase*, this Court expressly recognized the difference between economic protectionism and health and safety measures which are at the very core of the state's police power. However, because of the absolute ban imposed by the statute the state was required to show that the provision was narrowly tailored to serve that purpose. Because the Court found that it was not so tailored, the statute did not survive the "strictest scrutiny" test.

Because R.C. 5735.145(B) does not impose a ban on the shipment or sale in Ohio of ethanol produced in any state, it is not subject to the "strictest scrutiny" test. Furthermore, as detailed earlier in this argument, R.C. 5735.145(B) is a health and safety measure and is narrowly tailored to serve the purpose of protecting its citizens by encouraging measures which will directly result in a safer and cleaner environment. Because it is so tailored, the statute could survive the "strictest scrutiny" test, even assuming, *arguendo*, that it was applicable.

The statute at issue in *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511 (1935), prohibited the sale of out-of-state produced milk in New York unless the price paid to producers was the same as that paid to New York producers. It, like the statutes in *Great A & P Tea Co.* and *Sporhase*, imposed an absolute ban unless other states complied with the

statutory requirement. Additionally, the only plausible purpose of the provision was to protect the local milk industry. As such, it was simply an "economic protectionist" measure.

*Brown-Forman Distillery v. N.Y. State Liquor Auth.*, \_\_\_\_ U.S. \_\_\_\_, 106 S.Ct. 2080 (1986), involved a statute virtually identical in effect to that stricken in *Seelig*. The purpose was to directly regulate commerce by regulating activities of businesses in other states. In effect, the statute regulated the price at which these out-of-state distillers could sell their liquor in other states. The failure by those businesses to comply with that regulation could result in the revocation of the distiller's license to sell alcoholic beverages in New York. Simply stated, unless the distiller complied with the New York regulation, it could be absolutely banned from selling its goods in New York. Additionally, as was the statute in *Seelig*, the statute in *Brown-Forman* was found by the Court to be an economic protectionist measure.

*Pike v. Bruce Church, Inc.*, *supra*, is also inapposite to this case. The statute involved in that case was found to have the effect of forcing growers to move their packing operations to the enacting state by prohibiting a grower from shipping its cantaloupes out of Arizona unless they were packed in Arizona. The Court noted that statutes requiring business operations to be performed in the home state were viewed with particular suspicion and that such a burden on commerce has been considered virtually *per se* illegal. 397 U.S., at 145.

R.C. 5735.145(B) contains no such requirement. It does not have the effect of forcing ethanol producers to locate in Ohio. In fact, as noted earlier, all of the major competitors other than New Energy continue to sell to Ohio dealers with

no change or shifting in their operations. Additionally, unlike the grower in *Pike*, New Energy is not prohibited from shipping its product into Ohio.

*Pike* is also distinguishable because of the substantially different local interest sought to be advanced. The primary purpose of the Arizona legislation was to promote and preserve the reputation of Arizona growers, an interest which the Court labeled as "tenuous." 397 U.S., at 145. Balancing this "tenuous" state interest against the burden imposed on interstate commerce by requiring that a grower locate its business within the state, the Court found that the burden on interstate commerce was clearly excessive in relation to the local benefits.

It is particularly noteworthy that this Court distinguished this "tenuous" interest from legislation in the field of health and safety "where the propriety of local regulation has long been recognized." *Id.*, at 143. The Court made it clear that the reason it struck down the legislation was due to the minimal nature of the state interest rather than the extent of the burden on interstate commerce:

Such an incidental consequence of a regulatory scheme could perhaps be tolerated if a more compelling state interest were involved. But here the State's interest is minimal at best. . . .

*Id.*, at 146.

*Hunt v. Washington State Apple Advertising Commission*, 432 U.S. 333 (1977), is similarly inapposite to this case. Initially, a reading of that decision reveals that there was at least a strong suspicion by the Court that the purpose of the challenged statute prohibiting any labeling containing state quality grades on closed containers of apples shipped

into North Carolina was intended solely to give North Carolina growers a competitive edge. Second, the Court found that even if that was not the real purpose of the statute, the asserted purpose of protecting the consumers of the state was in fact disserved by the statute because it deprived them of all information regarding the quality of apples. Because the provision did not advance a legitimate state purpose, or did so only minimally, the burden on the flow of interstate commerce resulting from the additional repackaging costs and the loss of the competitive advantage Washington apples held in the marketplace was found to outweigh that state interest.

Not only is any incidental burden imposed on interstate commerce by R.C. 5735.145(B) less than that imposed by the Arizona or North Carolina legislation, but Ohio's interest in providing a cleaner and safer environment is a compelling state interest, unlike the tenuous interest of the Arizona legislation or the suspect purpose of the North Carolina statute. Additionally, unlike the statute in *Hunt*, R.C. 5735.145(B) does serve to advance the legitimate state purpose of assuring a safer environment. The burden imposed on interstate commerce by R.C. 5735.145(B) is not excessive in relation to the very real health benefits sought to be obtained by cleaning up the environment. Because the balance falls in favor of the enactment, the Ohio Supreme Court properly upheld R.C. 5735.145(B).

**CONCLUSION**

For the foregoing reasons, this appellee respectfully submits that the question upon which this case depends is so unsubstantial as not to need further argument, and appellee respectfully moves the Court to dismiss this appeal, or, in the alternative, to affirm the judgment entered in the cause by the Supreme Court of Ohio.

Respectfully submitted,

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**CERTIFICATE OF SERVICE**

The undersigned hereby certifies that a copy of the foregoing has been served by regular United States mail, first-class, postage prepaid, upon Herman Schwartz, Esq., 207 Myers Hall, 4400 Massachusetts Ave., N.W., Washington, D.C. 20016; David J. Young, Esq., Murphey, Young and Smith, 250 East Broad Street, Columbus, Ohio 43215, attorneys for appellant; and David C. Crago, Esq., 1900 Huntington Center, 41 South High Street, Columbus, Ohio 43215, attorney for appellee South Point Ethanol, on this \_\_\_\_ day of December, 1987. All parties required to be served have been served.

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**In the Supreme Court of the United States**

**October Term, 1987**

NEW ENERGY COMPANY OF INDIANA,

*Appellant,*

v.

JOANNE LIMBACH,

TAX COMMISSIONER OF OHIO, MARY ELLEN WITHROW,  
TREASURER OF OHIO, and SOUTH POINT ETHANOL,

*Appellees.*

**On Appeal from the Supreme Court of Ohio**

**JOINT APPENDIX**

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**Jurisdictional Statement Filed October 22, 1987**

**Probable Jurisdiction Noted December 14, 1987**

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DOCKET ENTRIES

*Complaint*, filed February 6, 1985.

*Motion for Preliminary Injunction*, filed February 7, 1985, and *Notice of Hearing*, set for February 27, 1985.

*Answer of Defendants*, filed March 12, 1985.

*Entry*, filed March 19, 1985. Plaintiff's motion for preliminary injunction consolidated with hearing on merits & trial on merits, March 29, 1985.

*Motion To Intervene as a Defendant*, served March 25, 1985—South Point Ethanol. Answer attached as Ex. A.

*Answer of New Party Defendant South Point Ethanol*, served March 27, 1985.

*Journal Entry*, filed March 27, 1985. South Point Ethanol has leave to intervene and made party.

*Agreed Findings of Fact*, filed April 3, 1985.

*Amended Agreed Findings of Fact*, filed April 10, 1985.

*Filings of Which the Court is Requested to Take Judicial Notice*, filed April 11, 1985.

*Decision and Judgment Entry*, filed April 23, 1985.

*Notice of Appeal*, filed April 24, 1985.

*Judgment Entry*, received April 29, 1985.

*Motion For Expedited Hearing and Decision*, filed April 29, 1985.

*Opinion and Order*, filed May 8, 1986.

*Journal Entry of Judgment*, filed May 8, 1986. Assignments of error OVERRULED; South Point's cross-assignment of error OVERRULED; Judgment of Franklin County Court of Common Pleas AFFIRMED.

*Notice of Appeal to the Supreme Court of Ohio*, filed May 14, 1986.

*Motion for Expedited Argument*, Filed August 15, 1986.

## DOCKET ENTRIES—Continued

*Notice of Hearing*, Received November 7, 1986.

*Judgment Entry* Reversing Judgment of Court of Appeals, with Opinion written by Judge Clifford J. Brown, and dissenting opinion written by Judge Holmes, Dated December 26, 1986.

*Motion of Appellee South Point Ethanol for Rehearing*, Filed January 5, 1987.

*Rehearing Entry*, Dated January 21, 1987.

*Supreme Court Announcement List*, Dated January 28, 1987.

*Motion of Appellant for Supersedeas or Injunctive Relief; for Correction of the Announcement List Dated January 28, 1987 and for Expedited Proceedings*, Filed February 3, 1987.

*Entry* (Denying Injunctive Relief; Denying Correction of Announcement List; Granting Expedited Proceedings, Dated February 25, 1987.

*Notice of Hearing on April 1, 1987*, Dated March 6, 1987.

*Motion of Appellant for Nunc Pro Tunc Order*, Filed March 9, 1987.

*Motion for Leave to File Amicus Curiae Brief*, Served March 10, 1987.

*Amicus Curiae Brief of Marathon Petroleum Company Urging Reversal*, Served March 10, 1987.

*Entry* denying *non pro tunc* order, Dated March 25, 1987.

*Entry* granting motion to file brief amicus curiae, Dated March 25, 1987.

*Opinion and Order* affirming Court of Appeals, September 2, 1987.

## DOCKET ENTRIES—Continued

*Motion of Appellant New Energy Company of Indiana for a Writ of Supersedeas or, In The Alternative, for Interim Injunctive Relief*, filed September 11, 1987.

*Notice of Appeal to The Supreme Court of The United States*, filed October 9, 1987.

*Jurisdictional Statement*, filed October 22, 1987.

*Probable Jurisdiction Noted*, December 14, 1987.

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IN THE COURT OF COMMON PLEAS,  
FRANKLIN COUNTY, OHIO

NEW ENERGY COMPANY OF )  
INDIANA, )  
3201 W. Calvert )  
P.O. Box 2289 )  
South Bend, Indiana 46680 )  
 )  
Plaintiff, )  
 )  
v. )  
 )  
JOANNE LIMBACH, )  
TAX COMMISSIONER, )  
STATE OF OHIO )  
30 East Broad Street )  
Columbus, Ohio 43215 )  
 )  
and )  
 )  
MARY ELLEN WITHROW, )  
TREASURER, STATE OF OHIO )  
30 East Broad Street )  
Columbus, Ohio 43215, )  
 )  
Defendants. )

Case No.  
85CV-02-712

*COMPLAINT*

1. This is an action for declaratory and injunctive relief brought pursuant to the provisions of Chapters 2721 and 2723 of the Ohio Revised Code. This action challenges the constitutionality of Ohio's new Ethanol Reciprocal Tax Credit legislation which creates a discriminatory and impermissible burden on interstate commerce.

*The Parties*

2. Plaintiff, New Energy Company of Indiana ("New Energy"), is an Indiana limited partnership engaged in interstate commerce in the business of manufacturing ethanol, an ingredient used in the blending of gasoline. New Energy was formed in 1982 and currently has a capital base of approximately \$185,000,000. There are approximately 3,300 limited partners in New Energy who have contributed approximately \$40 million in capital and have guaranteed an additional \$20 million of debt. The capitalization of New Energy includes bank loans in the approximate amount of \$140 million 90% of the principal and interest of which are guaranteed by the United States Department of Energy; direct loans from the United States Department of Energy and a direct loan from the South Bend Development Corp. which received an Urban Development Action Grant from the United States Department of Housing and Urban Development to assist in the development and construction of New Energy's ethanol production facility.

3. Joanne Limbach is the Tax Commissioner of the State of Ohio. Mary Ellen Withrow is the Treasurer of the State of Ohio. Together, the defendants are charged with the responsibility for administering and enforcing Ohio Revised Code Chapter 5735 dealing with motor vehicle fuel taxes.

*The Facts*

4. Ethanol is a high octane additive which is blended in ratios of up to 10% with gasoline. Blends of 90% gasoline and 10% ethanol are sometimes known as gasohol.

Ethanol is sold by manufacturers like New Energy to wholesalers, distributors, retail gasoline service station operators and others who, in turn, blend it with gasoline.

5. In order to encourage the use of ethanol, the United States Congress has enacted PL 96-294 ("The Energy Security Act"), which *inter alia*, provides for a lower federal excise tax on ethanol blends than on gasoline; 26 U.S.C. § 4081. Current federal law exempts ethanol blends from 6 cents of the 9 cent federal excise tax on gasoline. Approximately 32 states, including Ohio, have granted additional discounts, credits, exemptions or refunds for ethanol blends from their respective state sales taxes on gasoline. The use of ethanol advances national and state interests by expanding the agricultural markets in the United States and by reducing dependence on foreign oil.

6. Pursuant to Revised Code §§ 5735.05, 5735.25, 5735.29 and 5735.30, Ohio had a policy of providing a credit of 35¢ per gallon of ethanol when blended with gasoline in not more than 10% ratio and used, sold, or distributed by dealers in Ohio. This credit was available on all ethanol blends used, sold, or distributed by dealers in Ohio, regardless of where the ethanol ingredient of such blends were manufactured.

7. The tax treatment of ethanol-containing products was radically altered on December 20, 1984 when the Ohio General Assembly enacted R.C. § 5735.145 which provides as follows:

Sec. 5735.145 (A) As used in this section, and Sections 5735.13, 5735.14, 5735.141, 5735.142, 5735.146, and 5735.17 of the Revised Code:

(1) "Qualified fuel" means ethanol that is to be combined with gasoline to create a blend of not more than ten per cent by volume of ethanol and that when so blended is used, sold, or distributed as a motor vehicle fuel.

(2) "Ethanol" means:

(a) Ethanol produced in a manufacturing facility with an annual production capacity of less than two million gallons from wood or the grain of a cereal grass and denatured in accordance with United States Bureau of Alcohol and Tax Regulations; or

(b) Ethanol produced through a coal-fired process from wood or the grain of a cereal grass and denatured in accordance with United States Bureau of Alcohol and Tax Regulations.

(3) "Federal Gasohol Credit" means the amount per gallon on the last day of each month by which the federal tax on gasoline exceeds the federal tax on gasohol imposed under 26 U.S.C.A. 4081.

(4) "Qualified Fuel Credit" means thirty-five cents per gallon of qualified fuel minus the amount produced by the following computations:

(a) Subtract five cents from the federal gasohol credit. If the difference is a negative number, the qualified fuel credit shall be thirty-five cents, and no further computations shall be required.

(b) Multiply the difference thus obtained by ten. If the product exceeds thirty-five cents, the qualified fuel credit shall be zero.

The tax commissioner shall make such computations on the first day of each month, and the result of such computations shall be the cents per gallon qualified fuel credit for that month and each month thereafter until the amount of such credit is changed by the computations required by this division.

(B) *The qualified fuel otherwise eligible for the qualified fuel credit shall not contain ethanol produced outside Ohio unless the Tax Commissioner determines that the fuel claimed to be eligible for credit contains ethanol produced in a state that also grants an exemption, credit or refund from such state's motor vehicle fuel excise tax or sales tax for similar fuel containing ethanol produced in Ohio; provided however, that such credit shall not exceed the amount of the credit allowable for qualified fuel containing ethanol produced in Ohio.*

(C) Any dealer in motor vehicle fuel shall receive a credit on each gallon of qualified fuel used, sold, or distributed by the dealer and on which the dealer is liable for the taxes imposed by sections 5735.05, 5735.25, 5735.29, and 5735.30 of the Revised Code. To receive a credit, the dealer shall certify on the monthly report required by section 5735.06 of the Revised Code the number of gallons of qualified fuel used, sold, or distributed during the month to which the report applies and upon which such taxes are imposed. After computation of the amount of the tax in accordance with division (B) of section 5735.06 of the Revised Code, the number of gallons of qualified fuel used, sold, or distributed during the month to which the report applies and included in the gallons of motor vehicle fuel upon which the tax is imposed shall be multiplied by the cents per gallon qualified fuel credit applicable to that month. The resulting product shall be subtracted from the tax computed under division (B) of section 5735.06 of the Revised Code and shall constitute the credit provided by this section.

[Emphasis added]

8. The newly-enacted statute has a significant adverse effect upon plaintiff and will prevent plaintiff from competitively marketing its product in the State of Ohio. As interpreted by the State Tax Commissioner, the newly-

enacted Revised Code § 5735.145 will have the effect of denying some or all of the Ohio credit for blends used, sold, or distributed by Ohio dealers if the ethanol ingredient of the blend is manufactured in a state that does not give a credit in the same amount to ethanol manufactured in Ohio. In essence, the newly-enacted statute contains an impermissible reciprocal sales tax exemption.

9. The impact of the reciprocal sales tax exemption is being felt by plaintiff on a graduated basis during the period of January 1, 1985 through July 1, 1985. By July 1, 1985 the full effects and impact of the statute will be borne by plaintiff.

10. Plaintiff first began manufacturing and selling ethanol at its plant in South Bend, Indiana in October, 1984. Plaintiff currently sells a substantial portion of its production to Ohio purchasers for resale within the State of Ohio. In January, 1985 plaintiff sold approximately 262,000 gallons of ethanol in Ohio which were affected by the newly-enacted reciprocal sales tax statute. Plaintiff has also contracted to sell up to 1,000,000 gallons of ethanol per month to an Ohio dealer on a formula price basis. A major component of the formula's price is the Ohio credit. It is estimated that plaintiff will offer for sale approximately 1.7 million gallons of ethanol per month for resale in ethanol blends in the State of Ohio by July 1, 1985 and that this will constitute approximately 40% of plaintiff's monthly production of ethanol.

11. The prices paid to plaintiff by purchasers of ethanol are directly proportional to the amount of credit, exemption, discount or rebate from the sales or excise taxes imposed on resale dealers by the defendants. The

clear and unmistakable effect of the decreased exemptions or credits afforded plaintiff's product under the reciprocal sales tax exemption will be to significantly decrease the price paid to plaintiff by the retail purchasers of its product.

12. During the month of January, 1985 with the newly-enacted statute only partially phased into effect, plaintiff lost 10¢ per gallon on the sale of product affected by the statute. During the interim until July 1, 1985, plaintiff will continue to suffer monetary loss and will further suffer loss of customers and market position. Once the full effects of the statute are in place in July 1985, plaintiff's product will be subject to a 25¢ per gallon tax in addition to what is currently being assessed against the product. Based upon plaintiff's projected sales estimates, the discriminatory tax will subject plaintiff's product to an additional \$425,000 per month in taxes. Plaintiff's competitors who manufacture ethanol in Ohio will receive a 25¢ per gallon credit and be relieved of this additional burden.

13. The additional taxes imposed upon plaintiff's product are levied solely because the state in which the product is manufactured (Indiana) does not provide a specific credit or exemption for ethanol produced in Ohio. The Ohio taxing scheme is retaliatory and discriminatory against plaintiff's product and has the effect of placing plaintiff at a severe competitive disadvantage.

14. Defendants have interpreted the challenged legislation to require adjustment of plaintiff's credit by an unknown amount on a monthly basis until July 1, 1985 when the credit will terminate. This creates chaos in plaintiff's market. Plaintiff will continue to lose customers and will

be unable to schedule appropriate production. Given the current and forecast market for ethanol and the fact that New Energy is a new company, plaintiff will not find readily available alternative markets for its expected production. The maintenance of forecasted production rates is critical to New Energy's ability to satisfy its financial obligations and remain in existence.

15. The above could also cause many millions of dollars in losses to the United States Department of Energy and to thousands of limited partners throughout the country.

16. The injuries set forth herein are immediate and irreparable and plaintiff has no adequate remedy at law.

#### *First Claim for Relief*

17. Plaintiff realleges paragraphs 1-16 as if fully rewritten.

18. Section 5735.145(B) of the Revised Code of Ohio, as amended by Am. Sub. S.B. 334 of the 115th General Assembly, December 20, 1984, violates the Commerce Clause of the United States Constitution, Article 1, § 8, cl. 3, on its face and as applied because it discriminates against plaintiff and other manufacturers who sell, transfer or otherwise convey ethanol not manufactured in Ohio for use in gasoline sold in Ohio. Section 5735.145(B) thus discriminates against and imposes an impermissible burden on interstate commerce. It favors in-state manufacturers of ethanol to the disadvantage of out-of-state manufacturers.

#### *Second Claim for Relief*

19. Plaintiff realleges paragraphs 1-18 as if fully rewritten.

20. Section 5735.145(B), as amended, violates plaintiff's rights under the Privileges and Immunities Clause of the United States Constitution, Art. 4, § 2, because it deprives plaintiff of privileges and immunities afforded those who deal in ethanol manufactured in Ohio. The 1984 amendment to § 5735.145(B) violates the privileges and immunities clause by creating an economic barrier for ethanol manufactured outside Ohio thereby unreasonably discriminating against plaintiff and others who deal in ethanol manufactured outside Ohio.

*Third Claim for Relief*

21. Plaintiff realleges paragraphs 1-20 as if fully rewritten.

22. Section 1 of the Fourteenth Amendment to the United States Constitution provides, in part, that "No State shall . . . deny to any person within its jurisdiction the equal protection of the law." The 1984 Amendment to § 5735.145(B) violates the equal protection clause because its purpose and effect is to discriminate in favor of those dealing in Ohio ethanol, and to bestow undue economic advantage upon Ohio-manufactured ethanol by diverting business from those dealing in ethanol manufactured outside Ohio. This statutorily created classification is not reasonably related to any legitimate purpose of the legislation.

*Fourth Claim for Relief*

23. Plaintiff realleges paragraphs 1-22 as if fully rewritten.

24. Section 5735.145(B), as amended, violates the Constitution of Ohio by denying plaintiff equal protection

of law and granting Ohio producers of ethanol special privileges and immunities contrary to Article I, § 2 and Article II, § 26 of the Ohio Constitution.

WHEREFORE plaintiff demands judgment as follows:

A) A declaratoion that R.C. § 5735.145(B), as amended, which provides for a reciprocal tax credit is unconstitutional as being violative of the United States and Ohio Constitutions.

B) A preliminary and permanent injunction against defendants from implementing or enforcing the unconstitutional provisions of R.C. § 5735.145, as amended.

C) Such other further relief as may be appropriate, including the recovery of attorneys' fees and costs.

/s/ \_\_\_\_\_  
David J. Young (YOU02)

/s/ \_\_\_\_\_  
Fred J. Shoemaker (SHO07)

/s/ \_\_\_\_\_  
Kevin R. McDermott (MCD05)  
MURPHEY, YOUNG & SMITH  
A Legal Professional Association  
250 East Broad Street  
Columbus, Ohio 43215  
(614) 228-4371

*Attorneys for Plaintiff*

Of Counsel:

Herman Schwartz, Esq.  
4619 Chevy Chase Blvd.  
Chevy Chase, MD 20815

IN THE COURT OF COMMON PLEAS  
FRANKLIN COUNTY, OHIO

NEW ENERGY COMPANY  
OF INDIANA,

Plaintiff,

vs.

JOANNE LIMBACH,  
TAX COMMISSIONER,  
STATE OF OHIO,

and

MARY ELLEN WITHROW,  
TREASURER, STATE OF OHIO,

Defendants.

Case No.  
85CV-02-712

JUDGE  
CRAWFORD

ANSWER OF DEFENDANTS  
FIRST DEFENSE

1. The complaint fails to state a claim upon which relief can be granted.

SECOND DEFENSE

2. The court lacks jurisdiction over the subject matter.

THIRD DEFENSE

3. R.C. 5703.38 prohibits the court from granting the injunctive relief demanded by plaintiff.

FOURTH DEFENSE

4. Plaintiff lacks standing to sue with respect to the injunctive relief sought under R.C. 2723.01.

FIFTH DEFENSE

5. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraphs 2, 10, 11, and 15 of the complaint.

6. In response to paragraph 3 of the complaint, defendants admit that defendant Joanne Limbach, Tax Commissioner of Ohio, is charged with the responsibility of administering and enforcing R.C. Chapter 5735, but deny that defendant Mary Ellen Withrow, Treasurer of State, is charged with that responsibility.

7. In response to paragraph 4 of the complaint, defendants admit each of the allegations contained therein except that defendants are without knowledge or information sufficient to form a belief as to the allegation that ethanol is sold to retail gasoline service stations.

8. In response to paragraph 5 of the complaint, defendants admit the allegations contained therein regarding the federal incentives but are without sufficient knowledge or information to form a belief as to the truth of the allegations regarding the scope of the states' tax provisions concerning ethanol.

9. In response to paragraph 6 of the complaint, defendants admit that the allegations contained therein correctly state the law as it existed prior to January 1, 1985.

10. In response to paragraph 7 of the complaint, defendants admit the allegations contained therein with the exceptions of the statement that the tax treatment of ethanol blended gasoline was altered on December 20, 1984.

The enactment of R.C. 5735.145 became effective on January 1, 1985.

11. In response to paragraph 8 of the complaint, defendants admit the allegation contained in the second sentence of that paragraph, deny the allegation contained in the third sentence of that paragraph and are without knowledge or information sufficient to form a belief as to the truth of the allegations contained in the first sentence of that paragraph.

12. In response to paragraph 9 of the complaint, defendants deny that there is any sales tax exemption regarding ethanol. Assuming that plaintiffs meant to refer to the motor vehicle fuel tax credit, defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph 9 of the complaint.

13. In response to paragraph 12 of the complaint, defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations contained therein, except that defendants deny that plaintiff's product will be subject to an additional 25¢ per gallon tax or that a tax is currently being assessed against its product or that plaintiff's competitors will receive a 25¢ per gallon credit.

14. In response to paragraph 13 of the complaint, defendants deny that additional taxes are imposed upon plaintiff's product and that Ohio's taxing scheme is retaliatory and discriminatory against plaintiff's product. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegation that Ohio's taxing scheme places plaintiff at a severe competitive disadvantage.

15. In response to paragraph 14 of the complaint, defendants deny the allegation contained in the first sentence of that paragraph; the credit provided by the challenged legislation is available only to motor vehicle fuel dealers and plaintiff is not such an entity. Defendants are without knowledge or information sufficient to form a belief as to the truth of the remaining allegations contained in paragraph 14 of the complaint.

16. In response to paragraph 16 of the complaint, defendants admit that plaintiff has no adequate remedy at law. Defendants are without knowledge or information sufficient to form a belief as to the truth of the remaining allegations of paragraph 16 of the complaint.

17. Defendants deny each and every allegation contained in paragraphs 18, 20, 22, and 24 of the complaint.

ANTHONY J. CELEBREZZE, JR.  
Attorney General

/s/ Richard C. Farrin  
RICHARD C. FARRIN (FAR06)  
Assistant Attorney General  
State Office Tower—10 flr.  
30 East Broad Street  
Columbus, Ohio 43215  
(614) 466-3142

ATTORNEYS FOR  
DEFENDANTS

JOANNE LIMBACH  
TAX COMMISSIONER OF OHIO

MARY ELLEN WITHROW  
TREASURER OF THE  
STATE OF OHIO

(Certificate of Service omitted)

IN THE COURT OF COMMON PLEAS  
FRANKLIN COUNTY, OHIO

NEW ENERGY COMPANY	)	
OF INDIANA	)	
	)	
Plaintiff,	)	
	)	
vs.	)	
	)	Case No.
JOANNE LIMBACH,	)	85CV-02-712
TAX COMMISSIONER, <i>et al.</i> ,	)	
	)	JUDGE
and	)	CRAWFORD
	)	
SOUTH POINT ETHANOL	)	
P.O. Box 1004	)	
South Point, Ohio 45680,	)	
	)	
New Party Defendant.	)	

ANSWER OF NEW PARTY DEFENDANT  
SOUTH POINT ETHANOL

For its answer to the Complaint, new party defendant South Point Ethanol ("South Point"), admits, denies and alleges as follows:

1. Admits that the plaintiff purports to bring this action pursuant to the provisions of Chapter 2721 and 2723 of the Ohio Revised Code and seeks to challenge the constitutionality of certain Ohio statutes, and denies the remaining allegations contained in paragraph 1 of the Complaint.

2. Alleges that it is without sufficient information to form a belief as to the truth or falsity of the allegations contained in paragraph 2 of the Complaint.

3. Admits that Joanne Limbach is the Tax Commissioner of the State of Ohio and that Mary Ellen Withrow is the Treasurer of the State of Ohio.

4. Admits that ethanol is a high octane additive which is blended in ratios of up to 10% with gasoline and that blends of 90% gasoline and 10% ethanol are sometimes known as gasohol, but alleges it is without sufficient information to form a belief as to the truth or falsity of the remaining allegations contained in paragraph 4 of the Complaint.

5. Admits that Congress has enacted P.L. 96-294 and alleges that the terms thereof speak for themselves.

6. Admits that prior to January 1, 1985, Ohio had a credit for ethanol used, sold or distributed by dealers in Ohio regardless of where the ethanol was produced.

7. Admits that the Ohio General Assembly enacted Ohio Rev. Code § 5735.145, and alleges that the terms thereof speak for themselves.

8. Admits that the Tax Commissioner has correctly interpreted Ohio Rev. Code § 5735.145 to deny the Ohio credit for ethanol manufactured in a state that does not give a similar tax benefit to ethanol manufactured in Ohio, denies that the statute contains an impermissible exemption, and alleges it is without sufficient information to form a belief as to the truth or falsity of the remaining allegations contained in paragraph 8 of the Complaint.

9. Alleges it is without sufficient information to form a belief as to the truth or falsity of the allegations contained in paragraph 9 of the Complaint.

10. Alleges that it is without sufficient information to form a belief as to the truth or falsity of the allegations contained in paragraph 10 of the Complaint.

11. Alleges that it is without sufficient information to form a belief as to the truth or falsity of the allegations contained in paragraph 11 of the Complaint.

12. Denies that the statute is discriminatory, and alleges that it is without sufficient information to form a belief as to the truth or falsity of the remaining allegations contained in paragraph 12 of the Complaint.

13. Denies the allegations contained in paragraph 13 of the Complaint.

14. Alleges it is without sufficient information to form a belief as to the truth or falsity of the allegations contained in paragraph 14 of the Complaint.

15. Alleges it is without sufficient information to form a belief as to the truth of the allegations contained in paragraph 15 of the Complaint.

16. Denies the allegations contained in paragraph 16 of the Complaint.

17. Incorporates the admissions, denials and allegations contained in paragraphs 1-16 as though fully rewritten herein.

18. Denies the allegations contained in paragraph 18 of the Complaint.

19. Incorporates the admissions, denials and allegations contained in paragraphs 1-17 as though fully rewritten herein.

20. Denies the allegations contained in paragraph 20 of the Complaint.

21. Incorporates the admissions, denials and allegations contained in paragraphs 1-20 as though fully rewritten herein.

22. Denies the allegations contained in paragraph 21 of the Complaint.

23. Incorporates the admissions, denials and allegations contained in paragraphs 1-22 as though fully rewritten herein.

24. Denies the allegations contained in paragraph 22 of the Complaint.

25. Denies each and every allegation contained in the Complaint not herein expressly admitted to be true.

### FIRST DEFENSE

26. The Complaint fails to state a claim upon which relief can be granted.

### SECOND DEFENSE

27. Plaintiff lacks standing to sue with respect to the claims contained in the Complaint.

### THIRD DEFENSE

28. Plaintiff has failed to comply with the statutory requirements for commencing an action in Ohio.

WHEREFORE defendant South Point prays that the Complaint be dismissed at the plaintiff's costs.

David C. Crago (CRA 10)  
 Gail E. Griffith (RIS 04)  
 JONES, DAY, REAVIS & POGUE  
 1900 Huntington Center  
 41 South High Street  
 Columbus, Ohio 43215  
 (614) 469-3939  
 Attorneys for South Point Ethanol

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IN THE COURT OF COMMON PLEAS  
 FRANKLIN COUNTY, OHIO

NEW ENERGY COMPANY	)	
OF INDIANA,	)	
	)	Case No.
Plaintiff,	)	85CV-02-712
	)	
v.	)	Judge Crawford
	)	
JOANNE LIMBACH,	)	(Filed April 10,
TAX COMMISSIONER, et al.,	)	1985)
	)	
Defendants.	)	

AMENDED AGREED FINDINGS OF FACT

The parties agree that the record in this case supports these Agreed Findings of Fact. This agreement does not waive any objection by any party as to the relevancy of any agreed fact nor does it limit any party from proposing any additional findings of fact.

1. The plaintiff, New Energy Company of Indiana ("New Energy"), is an Indiana limited partnership engaged in Commerce among the states in the business of manufacturing ethanol. The plaintiff's manufacturing facility is located in South Bend, Indiana (Tr. 5). The plaintiff is the only ethanol manufacturer with production facilities in Indiana. Ethanol produced by New Energy is presently sold to blenders in several states including Ohio, Indiana and Illinois. (Plaintiff's Exs. 1 and 2)

2. New Energy was formed in 1980 and fully capitalized in 1982 by a public offering. The equity capital invested in the entity is \$40,000,000 and the equity inves-

tors guaranteed an additional \$20,000,000 in loans to the partnership (Tr. 5).

3. The total project cost of the New Energy facility was in excess of \$185,000,000. Approximately \$150,000,000 of the project cost was funded by bank loans, the principal of which is 90% guaranteed by the United States Department of Energy pursuant to the Energy Security Act of 1980. The United States Department of Energy has also made a direct loan to New Energy in the amount of \$1,769,000 (Tr. 7).

4. The state defendants are Joanne Limbach, Tax Commissioner of the State of Ohio, and Mary Ellen Withrow, Treasurer of the State of Ohio. Together these defendants are charged with the responsibility of administering and enforcing R.C. Chapter 5735 dealing with motor vehicle fuel taxes.

5. South Point Ethanol ("South Point") intervened in this action as a defendant on March 27, 1985. South Point is a joint venture between Ashland Oil Company, the Ohio Farm Bureau, UGI and Publicker Industries which produces ethanol in Lawrence County, Ohio.

6. South Point was formed in 1981 to retrofit a closed chemical plant. Its facility is located in South Point, Ohio. The joint venturers have invested approximately \$120,000,000 in South Point. Additionally, South Point provides approximately 185 jobs and expends \$100,000,000 annually in the production of ethanol from corn.

7. The plaintiff's complaint seeks a declaration that Ohio R.C. § 5735.145(B), as amended, is unconstitutional as being violative of the United States and Ohio Constitu-

tions. The complaint further seeks a preliminary and permanent injunction against defendants from implementing and enforcing the allegedly unconstitutional provisions.

8. Defendants answered the complaint and raised the affirmative defenses of failure to state a claim upon which relief can be granted, lack of jurisdiction over the subject matter, lack of standing to maintain the action and failure to comply with statutory requirements for commencing an action. In addition, the defendants allege that R.C. § 5703.38 prohibits the Court from granting the injunctive relief demanded by plaintiff and that plaintiff lacks standing to sue with respect to injunctive relief sought under R.C. § 2723.01.

9. Ethanol is a 199 proof alcohol. It is derived from corn which is treated with enzymes that convert the starch to sugar and ultimately into alcohol. Ethanol is mixed with gasoline in a 10/90% ratio to form a blend commonly referred to as gasohol (Tr. 14).

10. Ethanol is beneficial as a fuel additive to increase the octane rating of gasoline without contributing any additional lead into the environment. Ethanol is, in fact, the cost effective replacement for lead in gasoline and is the most environmentally benign replacement for lead. The production of ethanol also provides an outlet for the sale of corn surpluses (Tr. 9).

11. Various governmental bodies have initiated programs to encourage the production of ethanol. The United States Department of Energy grants for feasibility studies and guarantees 90% of certain qualifying loans (Tr. 9). To encourage the use of ethanol, the Department of Treas-

sury exempts ethanol/gasoline blends from 6¢ of the 9¢ federal excise tax on gasoline (Tr. 9). In addition, at least thirty-two states allow credits from their respective motor fuel taxes for ethanol/gasoline blends (Tr. 10). The provision of tax credits has been the best method adopted by the federal and state government to encourage the use of ethanol.

12. Ohio imposes a tax on dealers for each gallon of gasoline sold in Ohio. This tax is not imposed on, paid by, or collected by New Energy, South Point or any other producer of ethanol. Prior to January 1, 1985, Ohio law provided a tax credit of 35 cents per gallon for each gallon of ethanol blended with gasoline in not more than a 10% ratio and used, sold, or distributed by dealers in Ohio. This credit was available to dealers on all ethanol blends used, sold, or distributed in Ohio, regardless of where the ethanol ingredients of such blends were made (Tr. 19). (Plaintiff's Exs. 5 and 6)

13. Ohio's tax treatment of ethanol containing products was altered by the enactment of R.C. § 5735.145(B) which limits the availability of the credit to Ohio produced ethanol and ethanol produced in states which grant similar credits to ethanol produced in Ohio and sold within that state (Tr. 23). The newly enacted R.C. § 5735.145(B) provides that:

The qualified fuel otherwise eligible for the qualified fuel credit shall not contain ethanol produced outside Ohio unless the Tax Commissioner determines that the fuel claimed to be eligible for credit contains ethanol produced in a state that also grants an exemption, credit or refund from such state's motor vehicle fuel excise tax or sales tax for similar fuel containing

ethanol produced in Ohio; provided however, that such credit shall not exceed the amount of the credit allowable for qualified fuel containing ethanol produced in Ohio.

Prior to the adoption of R.C. § 5735.145(B) representatives of South Point testified before the House Ways and Means Committee of the Ohio General Assembly regarding all of the benefits of the use of ethanol, including, among other things, the public health benefits of its use as a substitute for lead as an octane enhancement in gasoline.

14. But for the enactment and operation of R.C. § 5735.145(B) plaintiff would receive identical tax treatment by the Ohio authorities as that accorded to any other Ohio dealer or producer of ethanol. The validity or invalidity of sub-section (B) does not affect any other provision of or the application of R.C. § 5735.145.

15. The tax credit provided for in R.C. § 5735.145(B) has been applied in the manner provided by R.C. Chapter 5735 on the ethanol sold by plaintiff in Ohio during January and February of 1985 (Tr. 25). (Plaintiff's Exs. 3 and 4).

16. The impact of the application of R.C. § 5735.145 is being felt by the plaintiff on a graduated basis during the period of January 1, 1985 through July 1, 1985. Dealers of gasohol containing ethanol produced by the plaintiff received the full 25¢ a gallon credit available to retailers on spot sales in Ohio during January and February of 1985 (Tr. 19). Prior to January 1, 1985 the credit available to dealers of gasohol containing ethanol was 35¢ per

gallon (Tr. 19). The credit applicable to dealers of gasohol containing ethanol produced by the plaintiff is recalculated monthly by the Ohio Department of Taxation (Tr. 24). During the month of March the credit was 24¢ per gallon. By July 1, 1985 R.C. § 5735.145(B) is fully applicable to all sales of ethanol by the plaintiff including both spot sales and contract sales (Tr. 23-24). After July 1, 1985 Ohio dealers of gasohol containing ethanol produced by the plaintiff will not receive any credit while retailers selling gasohol blended with non-Indiana ethanol will continue to receive 25¢ per gallon credit (Tr. 23). (Plaintiff's Exs. 7).

17. New Energy and South Point compete for the sale of ethanol to Ohio dealers with Archer Daniels Midland ("ADM"), Pekin Energy ("Pekin") and A. E. Staley ("Staley"). ADM and Pekin have production facilities in Illinois; Staley had production facilities in Tennessee. Ethanol produced in these facilities is entitled to the full Ohio credit. Additionally, ADM, Pekin and Staley have the capacity to supply the portion of the Ohio market for ethanol presently being filled by the plaintiff.

18. The evidence showed that the decreased credits afforded to retailers of blended gasoline containing plaintiff's product for January and February of 1985 decreased the price paid to plaintiff for its product (Tr. 27). (Plaintiff's Ex. 6) The decreased credits will continue to affect the price paid to plaintiff for its product through July 1, 1985. After July 1, 1985, the plaintiff believes that the application of R.C. § 5735.145(B) will affect the price paid to plaintiff for its product to the extent that the plaintiff will be unable to sell its ethanol in Ohio (Tr. 23).

19. The amount of state tax credit available to dealers of ethanol on a gallon of ethanol directly affects the per gallon price that dealers pay to ethanol producers in that the lower the available credit, the lower the price paid to ethanol producers for a gallon of ethanol (Tr. 28-29).

20. The continued enforcement of R.C. § 5735.145(B) will cause financial hardship to plaintiff.

By Agreement:

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/s/ by John K. Lines  
John K. Lines (LIN20)

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Attorneys for South Point Ethanol

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IN THE COURT OF COMMON PLEAS,  
FRANKLIN COUNTY, OHIO

NEW ENERGY COMPANY OF	)	
INDIANA,	)	
	)	
Plaintiff,	)	
	)	Case No.
v.	)	85CV-02-712
	)	
	)	Judge Crawford
JOANNE LIMBACH,	)	
TAX COMMISSIONER, et al.,	)	
	)	
Defendants.)	)	

NEW ENERGY COMPANY OF INDIANA'S  
POST-TRIAL ADDITIONAL PROPOSED  
FINDINGS OF FACT  
AND CONCLUSIONS OF LAW

(Filed April 5, 1985)

Pursuant to the Court's instructions, the parties filed Agreed Findings of Fact. The plaintiff submits the following additional findings of fact which are supported by the record for review and inclusion into the Court's findings but to which the parties could not agree. The new language in prior findings is underlined.

ADDITIONAL PROPOSED FINDINGS OF FACT

11. Various governmental bodies have initiated programs to encourage the *production and use* of ethanol (Tr. # 1, at 9). The United States Department of Energy provides loan guarantees and feasibility study grants to develop the technology to *produce* ethanol more efficiently (Tr. # 1, at 9). To encourage the *production and use* of ethanol, the Department of Treasury exempts

ethanol/gasoline blends from 6¢ of the 9¢ federal excise tax on gasoline (Tr. # 1, at 9-10). In addition, at least 32 states encourage the *production and use* of ethanol by allowing a credit from their respective motor fuel taxes for ethanol/gasoline blends (Tr. # 1, at 10). The provision of tax credits has been the best method adopted by the federal and state governments to encourage the *production and use* of ethanol.

20. The continued enforcement of R.C. § 5735.145(B) will cause *severe* financial hardship to plaintiff and threaten plaintiff's continued viability (Tr. # 1, at 44).

21. Representatives of South Point lobbied the Ohio General Assembly to enact the reciprocity provision provided for in R.C. § 5735.145(B) for the stated purpose of providing an incentive to other states to pass similar legislation (Tr. # 2, at 57 and 60).

22. Intervenor raised the issue of necessary filings with the Secretary of State by the plaintiff and New Energy Corporation of Indiana, the general partner of the plaintiff. Although Ohio R.C. § 1782.49 was not effective until at least April 1, 1985, if after a review of the legal authorities cited by intervenor, plaintiff believes that the subsequent filings made by it are relevant, additional findings of fact concerning these filings (of which the Court may take judicial notice), will be presented along with the Reply Brief:

## CONCLUSIONS OF LAW

Conclusion # 1: Plaintiff, New Energy Company, has standing to come before this Court and challenge the validity of R.C. § 5735.145(B) under the United States Constitution.

*Authorities in Support of Conclusion # 1*

Even though New Energy Company of Indiana ("New Energy Company") is not a "taxpayer under R.C. 5735.145 it nevertheless has standing to challenge the reciprocity legislation because it has suffered injury in fact and is a person whose rights are affected by the newly enacted legislation. In *Miller v. Publicker Industries, Inc.*, No. 65,839, slip op., (Sup. Ct. Fla. Oct. 11, 1984), the Supreme Court of Florida held that a person need not be a "taxpayer" to challenge the constitutionality of a tax statute. The Court stated that:

A party may challenge the constitutionality of a statute after showing that enforcement of the statute will injuriously affect the plaintiff's personal property rights . . . . In the present case Publicker presented evidence that, due to removal of the exemption on gasohol with foreign source alcohol, blender/distributors of gasohol in Florida either will not purchase or will require a substantial reduction in price before purchasing foreign ethyl alcohol. Publicker demonstrated the devastating effect this statute has had on its business. It must continue to pay fixed expenses while unable to sell its alcohol in Florida at an economically viable price. *The legislature may not protect a tax statute from constitutional review merely by ensuring that someone other than the party whose business is adversely affected must pay the tax . . . .* We therefore agree with the trial court's

finding that Publicker had standing to challenge [the statute] . . . .

[*Miller v. Publicker Industries, Inc.* No. 65,839 (Sup. Ct. Fla. Oct. 11, 1984) (emphasis added).]

Similarly, *Bacchus Imports, Ltd. v. Dias*, 468 U.S. —, 82 L.Ed. 2d 200, 104 S. Ct. 3049 (1984) and *Boston Stock Exchange v. State Tax Comm'n.*, 429 U.S. 318, 50 L.Ed. 2d 514 (1977) resolve any doubt about standing. In *Bacchus Imports, Ltd.*, the United States Supreme Court stated that:

The State presents a claim not made below that the wholesalers have no standing to challenge the tax because they have shown no economic injury from the claimed discriminatory tax. The wholesalers are, however, liable for the tax. Although they may pass it on to their customers, and attempt to do so, they must return the tax to the state whether or not their customers pay their bills. Furthermore, even if the tax is completely and successfully passed on, it increases the price of their products as compared to the exempted beverages, and *the wholesalers are surely entitled to litigate whether the discriminatory tax has had an adverse competitive impact on their business. The wholesalers plainly have standing to challenge the tax in this Court.*

[82 L.Ed. 2d 206-207 (emphasis added).]

Likewise, in *Boston Stock Exchange*, the third footnote indicates the United States Supreme Court's response to the lack of standing argument raised by the New York State Tax Commissioner:

We also agree that the Exchanges have standing under the two-part test of *Data Processing Service v.*

*Camp*, 397 U.S. 150, 25 L.Ed. 2d 184, 90 S. Ct. 827 (1970). Appellants' complaint alleged that a substantial portion of the transactions on their exchanges involved securities that are subject to the New York transfer tax, and that the higher tax on out-of-state sales of such securities diverted business from their facilities to exchanges in New York. [citation omitted] The allegation establishes that the statute has caused them "injury in fact," and that a case or controversy exists.

[50 L.Ed. 2d 514  
519.]

Conclusion # 2 This Court has jurisdiction to declare tax statutes unconstitutional as being violative of the United States and Ohio Constitutions.

*Authorities in Support of Conclusion # 2*

Ohio Law is settled that Ohio courts are fully authorized to grant a judgment declaring a tax statute unconstitutional. R.C. § 2721.03 provides as follows:

Any person interested under a deed, will, written contract, or other writing constituting a contract, or whose rights, status, or other legal relations are affected by a constitutional provision, statute, rule as defined in § 119.01 of the Revised Code, municipal ordinance, contract or franchise, may have determined any question of construction or validity arising under such instrument, constitutional provision, statute, rule, ordinance, contract, or franchise and obtain a declaration of rights, status, or other legal relations thereunder.

[Emphasis added.]

In *Fraternal Order of Police v. D'Amico*, 4 Ohio App. 3d 15 (1982), the Court of Appeals for Cuyahoga County

took the opportunity to interpret R.C. § 2721.03. In *Fraternal Order of Police*, the plaintiffs, as members of unions representing police and fire department employees, brought a declaratory judgment action to contest the validity of a municipal ordinance which set forth guidelines and directives for the use of sick leave benefits for city employees. The defendants argued that the Court of Common Pleas lacked jurisdiction because the complaint merely alleged that the plaintiffs would be affected in some "future abstract manner" and, therefore, the plaintiffs failed to invoke the Court's jurisdiction over an actual case or controversy.

The Court of Appeals, in finding that the complaint successfully invoked the Court of Common Pleas' jurisdiction, stated that:

... R.C. § 2721.03 allows for such a suit to determine the validity of a municipal ordinance . . . [s]ince appellee's rights are "affected" by a municipal ordinance, they may have the validity of such ordinance determined. Therefore, appellees successfully invoked the court's jurisdiction . . .

[4 Ohio App. 3d 15, 16]

Conclusion # 3 This Court is fully authorized to enjoin the enforcement of the provisions of R.C. § 5735.145(B).

*Authorities in Support of Conclusion # 3*

This conclusion of law is fully supported by plaintiff's *Post-Hearing Memorandum In Support Of Jurisdiction To Issue A Preliminary Injunction* filed with this Court.

Conclusion # 4 R.C. § 5735.145(B) creates an impermissible burden upon interstate commerce in violation of the Commerce Clause of

the United States Constitution (Art. I, § 8, cl. 3.).

*Authorities in Support of Conclusion # 4*

This conclusion of law is fully supported by the authorities cited on pages 1-15 of plaintiff's *Hearing Memorandum In Support Of Preliminary Injunction* filed with this Court.

*Additional Ohio Authorities in Support of Conclusion # 4*

Several Ohio Supreme Court cases have been instructive on the issue of tax statutes placing a burden on interstate commerce. In *Dayton Power & Light Co. v. Lindley*, 58 Ohio St. 2d 465 (1979) the plaintiff challenged the constitutionality of an Ohio coal consumption tax by asserting that it imposed a discriminatory tax on interstate commerce and impermissibly burdened commerce in violation of the Commerce Clause.

The plaintiff purchased coal for its Ohio generating plants from Ohio, Kentucky, and West Virginia and argued that the tax rate structures of the Ohio coal use tax encouraged the purchase of Ohio high sulphur coal and discouraged the purchase of out-of-state low sulphur coal. The Ohio Supreme Court, in holding that the tax statute violated the Commerce Clause of the United States Constitution, stated that:

The judiciary is not concerned with a legislative purpose that encourages "intrastate commerce and industry" or foster's interstate competition. It is only when the means by which that legitimate purpose is to be accomplished flies in the face of the United States Constitution that the judicial branch must become involved:

"Our decision today does not prevent the states from structuring their tax system to encourage the growth and development of intrastate commerce and industry. Nor do we hold that a State may not compete with other states for a share of interstate commerce; such competition lies at the heart of a free trade policy. We hold only that in the process of competition, no State may discriminatorily tax a product manufactured or the business operations performed in any other State." . . . For this court to place a judicial stamp of approval on the statutory scheme of taxation now before us would be to shrink our sworn duty, as members of the judicial branch of government, to support the Constitution of the United States.

[58 Ohio St. 2d 465,  
477 (citation omitted).]

Similarly, in *American Modulars Corp. v. Lindley*, 54 Ohio St. 2d 273 (1978), the Ohio Supreme Court struck down an Ohio use tax that assessed a tax on the plaintiff's use of tangible personal property purchased outside the State of Ohio but did not similarly tax tangible personal property purchased in the state. In holding that the use tax violated the Commerce Clause of the United States Constitution, the Ohio Supreme Court stated that:

Because goods used in taxing counties and purchased in non-taxing Ohio counties are not subject to a four and one-half (4½%) percent tax even though identically used goods purchased out-of-state are so taxed, R.C. § 5741.021 provides a direct commercial advantage to local purchases which impedes the free flow of trade between the states. . . . Indeed, R.C. § 5741.021 discriminates against out-of-state acquisitions as invidiously as it would if it subjected those purchases to unfavorable tax basis . . . or if there were no county sales tax at all. . . . Finally, the fact that R.C. § 5741.021 discriminates against interstate com-

merce only in its practical effect does not bar a finding that it is unconstitutional. . . . We, therefore, hold that R.C. § 5741.021 is unconstitutional insofar as its application imposes a higher tax rate on property purchased out-of-state and used in a taxing county that on similarly used property purchased in the state.

[54 Ohio St. 2d 273,  
278 (citations omitted).]

Conclusion #5 The Reciprocity Provisions in R.C. § 5735.145(B) are unconstitutional on their face.

*Authorities in Support of Conclusion #5*

This conclusion of law is fully supported by the authorities cited on pages 15-17 of plaintiff's *Hearing Memorandum In Support Of Preliminary Injunction* filed with this Court.

Conclusion #6 Ohio R.C. § 5735.145(B) violates the United States Constitution by denying plaintiff equal protection of the law.

*Authorities in Support of Conclusion #6*

This conclusion is fully supported by the authorities cited on page 19 of plaintiff's *Hearing Memorandum In Support of Preliminary Injunction* filed with this Court.

*Additional Authority in Support of Conclusion #6*

In a more recent decision, the United States Supreme Court struck down an Alabama domestic preference tax statute as violative of the equal protection clause. In *Metropolitan Life Insurance Co. v. Ward*, U.S. Sup. Ct. No. 83-1274 (March 26, 1985), an Alabama domestic preference tax statute imposed a substantially lower gross premium

tax rate on domestic insurance companies than on out-of-state insurance companies. In finding that the promotion of domestic business within a state, by discriminating against foreign corporations that wish to compete by doing business there, is not a legitimate state purpose, the Court stated that:

The effect of the statute as issue here is to place a discriminatory tax burden on foreign insurers who desire to do business within the State, thereby also incidentally placing a burden on interstate commerce. Equal protection restraints are applicable even though the effect of the discrimination in this case is similar to the type of burden with which the Commerce Clause also would be concerned . . . In whatever light the state's position is cast, acceptance of its contention that promotion of domestic industry is always a legitimate state purpose under equal protection analysis would eviscerate the Equal Protection Clause in this context. A State's natural inclination frequently would be to prefer domestic business over foreign. If we accept the State's view here, then any discriminatory tax would be valid if the State could show it reasonably was intended to benefit domestic business. A discriminatory tax would stand or fall depending primarily on how a State framed its purpose—as benefitting one group or as harming another. This is a distinction without a difference, and one that we rejected last term in an analogous context arising under the Commerce Clause. *Bacchus Imports, Ltd. v. Diaz*, 468 U.S., at — . . . We hold that under the circumstances of this case, promotion of domestic business by discriminating against nonresident competitors is not a legitimate state purpose.

[*Metropolitan Life Insurance Co. v. Ward*, No. 83-1274 slip. op. at 11-12 (March 26, 1985) (citation omitted).]

Conclusion #7 Ohio R.C. § 5735.145(B) violates the Constitution of the United States by granting Ohio ethanol producers special privileges and immunities contrary to Art. IV, § 2, cl. 1.

Authorities in Support of Conclusion #7

This conclusion is fully supported by the authorities cited on pages 17-18 of plaintiff's *Hearing Memorandum In Support Of Preliminary Injunction* filed with this Court.

Conclusion #8 R.C. § 5735.145(B) is severable from the remaining provisions of R.C. § 5735.

Authorities in Support of Conclusion #8

Plaintiff challenges only that portion of R.C. § 5735 that burdens interstate commerce with the reciprocity requirement. R.C. § 5735.145(B) is clearly severable. R.C. § 1.50 states that:

If any provisions of a section of the revised code were the application thereof to any person or circumstances held invalid, the invalidity does not affect other provisions or applications of the section or related sections which can be given effect without the invalid provision or application, into this end, provisions are severable.

The Miami County Court of Appeals specifically addressed the severability issue in *Livingston v. Clawson*, 2 Ohio App. 3d 173 (1982). The concluding paragraph in *Livingston* presents the proper interpretation of R.C. § 1.50.

While R.C. 1.47 indicates a presumption that an entire statute is intended to be effective, the legislature clearly, in R.C. 1.50 provided for the event their legisla-

tion might be determined by courts to be partially invalid or unconstitutional. It was the legislature's clear intent that other provisions of legislation not determined to be invalid be given effect where just and reasonable result capable of execution can be effectuated. Sections 1, 2, and 4 of Am. Sub. H. B. No. 1122 can be so effectuated and we find the trial court properly ruled the appellees are entitled to be compensated consistent with the provisions of that legislation.

[2 Ohio App. 3d 173, 178].

Respectfully submitted

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(Certificate of Service Omitted)

## ATTACHMENT A

## (A) Ohio Revised Code § 5735.145(B)

The qualified fuel otherwise eligible for the qualified fuel credit shall not contain ethanol produced outside Ohio unless the tax commissioner determines that the fuel claimed to be eligible for credit contains ethanol produced in a state that also grants an exemption, credit or refund from such state's motor vehicle fuel excise tax or sales tax for similar fuel containing ethanol produced in Ohio; provided however, that such credit shall not exceed the amount of the credit allowable for qualified fuel containing ethanol produced in Ohio.

## (B) Commerce Clause of the United States Constitution (Art. I, § 8, cl. 3).

The Congress shall have the Power . . . to regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes;

## (C) Equal Protection Clause

## (1) United States Constitution (Amendment 14, § 1).

All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No state shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any state deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

## (2) Ohio Constitution (Art. I, § 2).

All political power is inherent in the people. Government is instituted for their equal protection and benefit, and they have the right to alter, reform, or abolish the same, whenever they may deem it neces-

sary; and no special privileges or immunities shall ever be granted, that may not be altered, revoked, or repealed by the General Assembly.

## (D) Privileges and Immunities Clause

## (1) United States Constitution (Art. IV, § 2, cl. 1).

The Citizens of each State shall be entitled to all Privileges and Immunities of Citizens in the several States.

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IN THE COURT OF COMMON PLEAS,  
FRANKLIN COUNTY, OHIO

NEW ENERGY COMPANY	)	
OF INDIANA,	)	
	)	
	)	Plaintiff,
vs.	)	Case No.
	)	85CV-02-712
	)	
JOANNE LIMBACH,	)	Judge Crawford
TAX COMMISSIONER, <i>et al.</i> ,	)	
	)	
Defendants.	)	

PROPOSED ADDITIONAL FINDINGS OF FACT  
AND CONCLUSIONS OF LAW OF DEFENDANTS  
JOANNE LIMBACH, TAX COMMISSIONER OF OHIO,  
AND MARY ELLEN WITHROW, TREASURER  
OF OHIO

(Filed April 10, 1985)

FINDINGS OF FACT

1. It is conceivable that the Ohio General Assembly may have had several purposes in enacting R.C. 5735.145 (B), none of which were explicitly declared in the enactment itself. One of these purposes was to provide a cleaner and safer environment for Ohio citizens by encouraging the use of ethanol as a replacement for lead in gasoline not only in Ohio but in all states.

CONCLUSIONS OF LAW

1. Plaintiff cannot maintain this action under R.S. 2723.01 because only taxpayers can maintain such an action and plaintiff is not a taxpayer with respect to the Ohio Motor Vehicle Fuel Tax.

2. This Court is without authority to grant the injunctive relief requested by plaintiff.

3. As a regularly enacted statute, R.C. 5735.145(B) is entitled to a strong presumption of constitutionality which may be overcome only by a showing that it is clearly unconstitutional beyond a reasonable doubt. Plaintiff had the burden of establishing that this provision was in undoubted violation of some state or federal constitutional provision.

4. Plaintiff has failed to meet its burden of establishing that R.C. 5735.145(B) is clearly unconstitutional beyond a reasonable doubt. Therefore, that provision must be upheld.

5. R.C. 5735.145(B) has neither a discriminatory purpose nor a discriminatory effect on interstate commerce. Therefore, it is valid under the Commerce Clause.

6. The purpose of R.C. 5735.145(B) is to provide a cleaner and safer environment for citizens of Ohio, which purpose is a legitimate state purpose and is advanced by the reciprocity provision which encourages the use of ethanol as a substitute for lead in gasoline.

7. The incidental effect, if any, that R.C. 5735.145(B) has on interstate commerce is easily outweighed by the benefits to the health and safety of the citizens of Ohio that will result from enforcement of the statute. Therefore, because the effects of R.C. 5735.145(B) on interstate commerce are not excessive in relation to the local benefits, it must be upheld.

8. The Privileges and Immunities Clause affords protection only to natural persons. A partnership is not a

natural person, particularly when the sole partner is a corporation. Because plaintiff is a partnership it is not protected by the Privileges and Immunities Clause. Therefore, R.C. 5735.145(B) must be upheld against plaintiff's Privileges and Immunities challenge.

9. Even if plaintiff was within the class protected by the Privileges and Immunities Clause, R.C. 5735.145(B) is not in violation of that provision because it does not constitute an intentional discrimination operating to the disadvantage of all nonresidents and favoring all residents.

10. R.C. 5735.145(B) is rationally related to the legitimate state purpose of providing a cleaner and safer environment and therefore does not violate the Equal Protection Clause of either the United States or the Ohio Constitution.

Respectfully submitted,

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ATTORNEYS FOR JOANNE LIMBACH,  
TAX COMMISSIONER OF OHIO, and MARY ELLEN WITHROW,  
TREASURER OF STATE

(Certificate of Service Omitted)

IN THE COURT OF COMMON PLEAS OF  
FRANKLIN COUNTY, OHIO  
CIVIL DIVISION

NEW ENERGY COMPANY	)	
OF INDIANA,	)	
	)	
PLAINTIFF,	)	CASE NO.
	)	85CV-02-712
VS.	)	
	)	JUDGE
JOANNE LIMBACH	)	CRAWFORD
TAX COMMISSIONER, et. al.,	)	
	)	
DEFENDANTS.	)	

JUDGMENT ENTRY

Judgment is hereby rendered in favor of the Defendants in accordance with this Court's Decision of April 23, 1985.

The Court finds that *Revised Code* Section 5735.145 does not violate the Privileges and Immunities, the Equal Protection or the Commerce Clauses of the United States Constitution. Case Dismissed.

Costs to Plaintiff.

DATE: \_\_\_\_\_

/s/ DALE A. CRAWFORD, JUDGE

APPROVED:

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Attorney for Plaintiff

Richard C. Farrin, Esq.  
Attorney General's Office  
Attorney for Joanne Limbach  
and Mary Ellen Withrow

David C. Crago, Esq.  
Attorney for South Point Ethanol

IN THE COURT OF APPEALS OF OHIO  
TENTH APPELLATE DISTRICT

New Energy Company of Indiana,	)	
	)	
Plaintiff-Appellant,	)	85 CV 02-712
	)	
v.	)	No. 85 AP-340
	)	(REGULAR
Joanne Limbach, et al.,	)	CALENDAR)
	)	
Defendants-Appellees.	)	

JOURNAL ENTRY OF JUDGMENT

For the reasons stated in the opinion of this court rendered herein on May 8, 1986, the assignments of error are overruled, and defendant South Point's cross-assignment of error is overruled, and it is the judgment and order of this court that the judgment of the Franklin County Court of Common Pleas is affirmed.

WHITESIDE and McCORMAC, JJ.

/s/ By Judge Alba L. Whiteside

cc: David J. Young,  
Kevin R. McDermott and  
John K. Lines  
Herman Schwartz  
Richard C. Farrin  
David C. Crago,  
James R. King and  
Gail E. Griffith

THE SUPREME COURT OF OHIO  
COLUMBUS

New Energy Company of Indiana,	)	
	)	1986 TERM
Appellant,	)	To Wit:
	)	December 26, 1986
v.	)	Case No. 86-784
	)	
Joanne Limbach, Tax	)	JUDGMENT
Commissioner, et al.,	)	ENTRY
	)	APPEAL FROM
Appellees.	)	THE COURT
	)	OF APPEALS

This cause, here on appeal from the Court of Appeals for Franklin County, was considered in the manner prescribed by law. Upon consideration thereof, judgment of the Court of Appeals is reversed consistent with the opinion rendered herein.

It is further ordered that the appellant recover from the appellees its costs herein expended; and that a mandate be sent to the Court of Common Pleas to carry this judgment into execution; and that a copy of this entry be certified to the Court of Appeals for Franklin County for entry.

/s/ Frank D. Celebrezze  
FRANK D. CELEBREZZE  
Chief Justice

FOR YOUR INFORMATION ONLY  
NOT FOR FILING

I, James Wm. Kelly, Clerk of the Supreme Court of Ohio, do hereby certify that the foregoing order was correctly copied from the records of said Court, to wit, from the Journal.

IN WITNESS WHEREOF, I have hereunto  
subscribed my name and affixed the seal of said  
Supreme Court, on this date \_\_\_\_\_.

JAMES WM. KELLY, CLERK  
/s/ Daniel J. Crowley, Deputy

THE SUPREME COURT OF OHIO  
COLUMBUS

New Energy Company of Indiana,	)	
	)	1987 TERM
Appellant,	)	To wit:
	)	January 21, 1987
v.	)	Case No. 86-784
	)	REHEARING
Joanne Limbach, Tax	)	ENTRY
Commissioner, et al.,	)	(Franklin
	)	County)
Appellees.	)	

It is ordered by the Court that rehearing in this case  
be, and the same is hereby, granted.

/s/ Thomas J. Moyer  
Chief Justice

FOR YOUR  
INFORMATION  
ONLY  
NOT FOR FILING

I, Robert L. Edington, Acting Clerk of the Supreme  
Court of Ohio, do hereby certify that the foregoing order  
was correctly copied from the records of said Court, to  
wit, from the Journal.

IN WITNESS WHEREOF, I have hereunto sub-  
scribed my name and affixed the seal of said Supreme  
Court, on this 21st day of January, 1987.

Robert L. Edington Acting Clerk  
/s/ J. A. Redd Deputy

THE SUPREME COURT OF OHIO  
COLUMBUS

New Energy Company of	)	
Indiana,	)	
	)	1987 TERM
Appellant,	)	
	)	To wit:
v.	)	February 25, 1987
	)	
Joanne Limbach, Tax	)	Case No. 86-784
Commissioner, et al.,	)	
	)	ENTRY
Appellees.	)	

This cause is here on appeal from the Court of Ap-  
peals for Franklin County. The Court, having granted a  
rehearing of this cause, now comes to consider additional  
matters filed herein. Upon consideration of the appel-  
lant's motion for a supersedeas bond or injunction relief  
or, in the alternative, for correction of the Announcement  
List dated January 28, 1987, or, in the alternative, for  
acceleration of reconsideration proceedings,

IT IS ORDERED by the Court that said request for  
bond or injunctive relief be, and the same is hereby, de-  
nied; and that said request for correction of the Announce-  
ment List be, and the same is hereby, denied.

IT IS FURTHER ORDERED by the Court that said  
request for acceleration of reconsideration proceedings be,  
and the same is hereby, granted.

IT IS FURTHER ORDERED by the Court that appellant shall file its merit brief 5 days after the receipt of this order, that appellees shall file their merit brief 5 days after the appellant files its merit brief and that appellant shall file its reply brief 5 days after appellees file their merit brief.

IT IS FURTHER ORDERED by the Court, *sua sponte*, that the opinion announced in this cause on December 26, 1986, is hereby vacated and set aside and that publication thereof is withheld from the Ohio Official Reports Advance Sheets pending further proceedings in this Court.

/s/ Thomas J. Moyer  
Chief Justice

I, Robert L. Edington, Acting Clerk of the Supreme Court of Ohio, do hereby certify that the foregoing order was correctly copied from the records of said Court, to wit, from the Journal.

IN WITNESS WHEREOF, I have hereunto subscribed my name and affixed the seal of said Supreme Court, on this 25th day of February, 1987.

Robert L. Edington Acting Clerk  
/s/ J. A. Redd Deputy

THE SUPREME COURT OF OHIO  
COLUMBUS

New Energy Co. of Indiana,	)	
	)	1987 TERM
Appellant,	)	
	)	To wit:
v.	)	March 25, 1987
	)	
Joanne Limbach, Tax Commr.,	)	Case No. 86-784
et al.,	)	
	)	E N T R Y
Appellees.	)	

This cause is pending before the Court for further consideration of the appeal from the Court of Appeals for Franklin County and upon consideration of the appellant's motion for *nunc pro tunc* order,

IT IS ORDERED by the Court that said motion be, and the same is hereby, denied.

/s/ Thomas J. Moyer  
Chief Justice

I, Robert L. Edington, Acting Clerk of the Supreme Court of Ohio, do hereby certify that the foregoing order was correctly copied from the records of said Court, to wit, from the Journal.

IN WITNESS WHEREOF, I have hereunto subscribed my name and affixed the seal of said Supreme Court, on this 25th day of March, 1987.

Robert L. Edington Acting Clerk  
/s/ J. A. Redd Deputy

## TRANSCRIPT OF PROCEEDINGS

March 1, 1985

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(p. 3) BARRY DIRENFELD

called as a witness on behalf of the plaintiff, being first duly sworn, testified as follows:

## DIRECT EXAMINATION

By Mr. Young:

Q. State your name.

A. Barry Direnfeld (spelling) D-i-r-e-n-f-e-l-d.

Q. And what is your address, sir?

A. 2500 North 24th Street, Arlington, Virginia.

Q. By whom are you employed?

A. New Energy Company of Indiana.

Q. In what capacity?

A. I am the president, chief executive officer.

Q. How long have you been so employed?

A. A little bit more than five years.

Q. Would you give us an abbreviated—because time is of the essence—resume of your educational background?

(p. 4) A. Yes. I received a BA degree from Kenyon College, 1971; I'm a graduate of Catholic University of American Law School, 1975.

I was admitted to the Ohio and District of Columbia Bar Associations.

I have served as an attorney for a law firm in Washington: Akin, Gump, Strauss, Hauer and Feld.

Prior to that I served as a chief counsel and staff director of the United States Judiciary Subcommittee on Antitrust Monopoly.

I have been a resident teaching fellow at Harvard University in [sic].

I have been chief legislative counsel for Howard Metzenbaum and served as legislative counsel to Richard Stone.

Q. Could you tell me what function your business is in?

A. We are in the business of producing ethanol for fuel purposes.

Q. Can you give me a brief description of how the ethanol was used that you produced?

A. Ethanol is used as an octane enhancer to be blended in a 90/10 ratio with gasoline. It was originally used to extend gasoline supplies in the late 1970's and early 1980s during our embargoes and can be used again (p. 5) during a crisis. It is a lead-free additive to replace lead in gasoline to increase the performance of automobiles.

Q. Where is your plant or your production plant located?

A. It is located in South Bend, Indiana.

Q. Is the location a crucial subject with respect to ethanol production plants?

A. Absolutely. The primary feed stock or the components of the produce is corn, so you will want to be located near corn.

The primary product is a petroleum substitute or petroleum additive so you want to be near petroleum refineries and markets where gasoline is consumed, and in addition to that, you want to be in a state that has supported the development of the market for ethanol as well as skilled labor available for industrial development generally.

Q. How long has your company been in existence and what is the present state of operation, if you are not at present stage of capacity?

A. New Energy Company of Indiana is a public limited partnership. It was formed in 1980 and fully capitalized in 1982 by virtue of a public offering. The capital, equity capital of New Energy is \$40,000,000. The (p. 6) equity investors have also guaranteed, either through cash or personal guarantees, another \$20,000,000 of the loans to the partnership.

We commenced construction of the facility in 1982. We placed the produce in service in October of 1984. We are currently in our start-up phase of operation and we are moving toward full capacity. We are probably producing today at the level of 75 to 80 percent of capacity.

Q. What would that be per month? How many gallons per month?

A. We are at the rate right now of three, three-and-a-half million gallons a month of capacity. Our maximum or full capacity is 4.7 million gallons per month.

Q. So you will, when you reach full capacity, gain additional markets?

A. Yes. We have had as a start-up company or as a start-up plant, we had to go from little marketing and bring it up in large increments, the first one or two million came slowly, and once you've made your modifications you'll increase production at very substantial rates, so we will have to continue to expand our market rapidly.

Q. I believe you testified earlier, Mr. Dierenfeld, that you obtained capitalization through equity capital of \$40,000,000, and the investors guaranteed an additional \$20,000,000 in debt. Was that the extent for debts for (p. 7) capitalization of this project?

A. No. The total project cost was in the neighborhood of in excess of \$185,000,000. The principal loan to the project is a loan of \$140,914,000. And that loan was made by a syndicate of banks led by the First National Bank of Chicago. 90 percent of the principal and interest of that loan was guaranteed by the United States Department of Energy pursuant to the Energy Security Act of 1980.

In addition to that, the project has received a direct loan from the Department of Energy in the amount of \$1,769,000.

Finally, the partnership has a loan to the South Bend Development Corporation to repay certain funds that the City of South Bend received from the Urban Development Action Grant provided it by the United States Department of Housing and Urban Development.

Q. Could you explain for the court why, to the extent you know, the United States Government and the Depart-

ment of Energy has made this sort of a commitment to the ethanol plant that you operate?

. . .

(p. 8) Q. Instead of saying what the congressional intent was, I want your knowledge of the items of potential interest that justifies the enactment.

A. There are several items of interest that led to the development of this project, in my judgment. First, the production of ethanol is a renewable fuel because it comes from the production of corn and in corn, of course, that is renewed each year so the producing of liquid fuel from a renewable source creates a source of energy independent for our country.

The Energy Security Act of 1980 was passed to increase our country's independence from foreign oil of petroleum. It also targets ethanol because, in fact, it was able to reduce our agriculture surpluses by creating a very large domestic market for agriculture.

Today, for instance, over 2,000,000 bushels of corn are consumed from the production of ethanol and the (p. 9) program is only four or five months old. This market of 2,000,000 bushels approximates the amount we sell to the Soviet Union so you can see this has had a very significant impact on surpluses.

United States Department of Agriculture recently estimated that this increase demand has increased by 14 cents a bushel the value of our corn crops, which would translate into approximately a billion dollar increase in the real value of our corn, so that's a very real reason why

they chose ethanol to do that, and also because it provided an alternative to lead in gasoline.

Ethanol is the most environmentally benign substitute for lead and the policy of the environmental protection agency was to accelerate for health reasons the removal of lead from gasoline, and this also provided an alternative so we could, in fact, have the octane necessary to run our cars and still have the health benefits of ethanol.

For those reasons, the federal government created a number of programs designed to promote the development of ethanol. One is the Energy Security Act which provided loan guarantees, feasibility study grants to develop the technology to produce more efficiently ethanol as well as the tax—I'm not sure of the tax provision exactly in citing it; however, it provided an exemption for ethanol (p. 10) gasoline blends for the payment of the six cents out of the nine cents for the federal excise tax on gasoline.

Q. In addition to the federal credit that you have spoken of, do you find that many states have also enacted credit legislation in order to foster the production of ethanol?

A. Yes, currently 32 states have enacted credits to promote the development and sale of ethanol blends in their states.

Q. Now, in order to have the record clear on this, what is the current federal credit grant by the federal government for consumption of ethanol?

A. It exempts ethanol-alcohol blends which are in the 90/10 percent ratio, from six cents of the nine cents

excise tax on gas. It provides a six cents per gallon blender tax credit to blenders of alcohol who don't want to blend 90/10 percent. So the value is 60 cents a gallon.

\* \* \*

(p. 11) The Witness: A gallon of ethanol, in order to be sold as motor fuel, cannot exceed 10 percent of the blend. You sell 90 percent gas and 10 percent ethanol so the gallon of this blend would only have a tenth of a gallon of ethanol in it. That blend is exempt from six cents of the tax, so in order to find out the exact value of a gallon of ethanol, it would be times 10 so you get to 60 cents so the value of the credit to a gallon of ethanol is 60 cents; the value to the blend is six cents. It is very confusing.

Q. That's because a gallon of ethanol would be split, in effect, over 10 gallons of blended gas?

A. That's right, that's right. There would be 10 gallons of blended gas for every one gallon of ethanol.

Q. So you are multiplying the six by 10?

A. That's correct.

Q. Let me, if I might, show you two documents. First of all, plaintiff's exhibit no. 1 and plaintiff's exhibit no. 2, and I have already shown those to counsel, and would you tell us what plaintiff's exhibit 1 is, sir?

A. It is an aerial view of New Energy production fuel facility in West Bend and it was taken prior to our plant dedication on October 24th, 1984. You can see most of the heart of the production facility.

Q. Let me hand you that which has been previously (p. 12) marked as plaintiff's exhibit 2 and ask you to identify that, if you would.

A. This is an identity brochure that New Energy uses in conjunction with marketing to both identify the use of ethanol as well as to establish new energy's position in the marketplace.

Q. Let me cover one other point and then we will move back and get a brief description of how ethanol is produced.

You have described for us the amount of the federal tax credit with respect to this production process and you have also listed from your personal knowledge some potential knowledge of federal interest in the production.

Are you able to tell us the cost to the federal government of granting these credits for ethanol production?

A. Last year at the request of congress, they asked the very same question of the general accounting office which is the accounting agency that congress uses to evaluate macro economic effects of certain laws. The conclusion came back from the general accounting offices that because of the significant demand increase of corn by ethanol, it reduced government outlays in the agriculture budgets by reducing payments to farmers to not grow crops (p. 13) or pay for government storage. In addition to that, what it did was increase dramatically the balance of the nature of our payments by backing out imported foreign crude oil.

An example of today's production of roughly 500,000,000 gallons would be roughly equivalent to 12,000,000 gal-

lons of crude oil. That would approximate \$300,000,000 enhancement of our balance of payments, so what they came back with was the forgo revenues by virtue of the excise tax exemption were more or less offset and they said there was no material cost to the government and recommended the continuation of the program through 1992.

Q. What I would like you to do at this time, if you would, Mr. Dierenfeld, is give us an abbreviated description of how ethanol is produced.

A. It is built off the traditional art of making moonshine whiskey and takes corn in our process and grinds up corn. We use 20,000,000 bushels of corn a year at New Energy at full production. A bushel of corn makes two-and-a-half gallons of ethanol.

We also gather the animal feed. It is sold as a high protein animal feed, particularly to dairy animals. We will produce 185 tons of animal feed.

In addition to that the process also creates (p. 14) carbon dioxide and we will recover our carbon dioxide and sell it to a production who's building a facility for processing foods and carbonated beverages. It is treated with enzymes to turn the starch in corn to sugar and there yeast is taken and cooked and converted into alcohol. The alcohol is stripped off, the animal feed is dried and this is how we produce alcohol.

You can see in the back there is a little utility company there with a coal pile.

Q. What proof of alcohol do you produce?

A. Just under 200, it is 199 plus.

. . .

Q. Would you briefly describe for the court the nature of your market; that is, perhaps the state in which you market your product and the identities of the types of (p. 15) consumers with whom you do business?

A. Our primary market to date consists of three states; the state of Indiana, Ohio, and Illinois. The reason for those markets are several.

First, because alcohol cannot, ethanol cannot be transported by pipeline. It has a very high cost of transportation so the reasonable cost is paramount to establishing the market.

Second, the availability of an acceptance in market place for ethanol is important and that's been stipulated in all three states by state incentive which has made it attractive for customers such as retailers, people who essentially are retailers of petroleum products or any users who will be mostly independent oil companies, to buy and blend the ethanol and sell it at their gasoline stations.

Q. What percentage then of these three states—what percentage are you now selling to Ohio consumers and then tell me what the percentage would be at full production according to your schedules.

A. I think today I would have to look at it, but it is in the neighborhood of 20 to 25 percent in Ohio. We are forecasting to go to 35 percent, which would equate to a million seven. 1,700,000 gallons per month in Ohio.

Q. How many gallons per month are you distributing (p. 16) in Ohio at the present time?

A. I would have to defer to Bob. I think probably in excess of a 1,000,000 gallons a month.

Q. Do you have contractual commitment consumers and spot sales?

A. We have a mixture of both. We have approximately 60 percent of our sales that are contracted, 60-65 percent and then 35 percent would be spot. In terms of long term contract, we have one long term contract which runs through the end of 1985, and that provides for a 1,000,000 gallon commitment and that happens to be to a customer in Ohio.

Q. 1,000,000 gallons a month?

A. That's right.

Q. And that runs through the end of '85?

A. That's correct.

Q. Now we have talked about its uses and production process: Can you tell us what's more expensive to produce a gallon of, regular gasoline or a gallon of ethanol blend?

A. Unfortunately a gallon of ethanol is far more costly than a gallon of gasoline at this time.

Q. We will get into that in a moment, but approximately what would be the two figures of the cost to produce a regular gallon of gas and the cost to produce (p. 17) a gallon of ethanol?

A. I think today a wholesale price of a gallon of gasoline would approximate 73 cents and our cost of producing ethanol is \$1.38, so the difference would be 60—

Q. With this difference in cost then, would you explain to the court how you would remain competitive and induce a consumer to purchase ethanol or ethanol blends rather than regular gasoline?

A. The only way we can currently do so is through the state and federal incentives or credits that exist, and absent those credits and ethanol would not be a viable factor in the market place today.

Q. If you could, give us a bird's eye view of the history of the marketing of ethanol as to when it first took place and what kind of volumes we are talking about there, and what volumes we have reached today in the nation.

Q. That's rather phenomenal actually. In 1980 approximately 50,000,000 gallons of ethanol was sold in the United States, which put ethanol blend at 10 times that or like 500,000,000 gallons. That's compared to 100,000,000 gallons of motor fuel, so it was virtually insignificant in the motor fuel mix as recently as 1980.

Since that time approximately—well industry estimates have it at about \$1,000,000,000 has been (p. 18) invested in capacity and consumption has gone up to approximately 500,000,000 of ethanol, which would put ethanol blend at 5,000,000,000—which is now approximately five percent of all gasoline in the United States has ethanol in it and that's over a period of five years.

Q. Let me ask you, and I will ask this question and see it if you can answer it with respect to both the federal tax credit and the Ohio tax credit that is granted for ethanol consumption.

Can you tell us who pays the tax and how?

A. Yes, it is paid as a deduction.

Mr. Farrin: I raise an objection here. Who pays the taxes determined by the specific statutes involved and I don't think it is proper for this witness to testify as to statutes that are clearly reviewable.

Mr. Young: I will reword the question, Mr. Farrin.

Q. Are you familiar with how the Ohio tax has been administered in the past?

A. Yes, I am.

Q. Are you familiar with how the credit, the ethanol credit is collected in Ohio?

A. Yes.

Q. I will ask you whether the motor fuel tax is paid by the employer or the gasoline station distributor.

(p. 19) A. It is paid by the distributor/retailer.

Q. When the retailer pays its motor fuel tax each month, is the credit that's available under the Ohio Ethanol Credit Legislation taken by that same retailer?

A. That's correct.

Q. Is it again the motor fuel tax?

A. That's correct.

Q. What is the amount of credit your retailers or were your retailers in Ohio receiving prior to the enactment of the legislation that is under challenge in this case, the ethanol provision credit of the legislation?

A. 35 cents per gallon.

Q. Okay. What is that general credit reduced to today?

A. 25 cents a gallon.

Q. Would you explain how that is reduced from 35 to 25?

A. The statute as I have read it—

Q. Don't interpret the statute, just give us your practical knowledge of what happened in the field.

A. The federal incentive, the federal credit on January 1, was increased from five cents a gallon to six cents a gallon and the Ohio statute reflected that increase and offset the Ohio credit to increase the credit from the (p. 20) federal government so it offset that 10 cent a gallon increase of the federal.

Q. So in other words, the seller of ethanol got the same credit before and afterwards, but afterwards the federal bore a greater portion?

A. That's right. It was just transferring a greater portion to the federal from the state.

Q. Let's first of all say prior to. Let's go back to the year 1984. Did Indiana have an ethanol credit incentive program?

A. Yes, commencing in 1977, the state of Indiana exempted all ethanol blends from its state sales tax on gasoline.

Q. A total exemption?

A. Yes, and that was in the amount of four percent.

Q. Okay. How many years did that remain in effect?

A. Until 1983 whereby it was reduced from four percent to three percent and scheduled to go back up to four percent on July 1 of 1984 so the effect was it was reduced by one percent for one year.

Q. The Ohio tax, according to your experience I believe as you have explained it, is based on a number of cents per gallon?

A. Yes, it is.

(p. 21) Q. Is the Indiana tax imposed similarly or does it have a different formula?

A. Because it is a percentage of the price of gasoline it floats with the price of gas. So if gasoline prices were to go down, the value as we have recently experienced, the value of the credit goes down with ethanol. I should note it is currently two-and-a-half percent.

Q. In Indiana?

A. That's right.

Q. Can you tell us which state has the highest percentage of gasoline sold as blended gasoline rather than regular?

A. It varies by which trade publication you look at but Indiana has been over 30 percent of all gasoline sold

in the state of Indiana, which has had it well, if not the highest, it has always been reported as one of the two highest for many years.

Q. Is there any state that all agree has laid out more in tax credit than any other state?

A. No, not in my judgment.

Q. Has there been a recent change in the Indiana law?

A. Yes, there has. Last year the Indiana exemption credit was reduced from the scheduled increase of four (p. 22) percent to two after Level C where it currently is, and is scheduled to be terminated on July 1 of '85; this year.

Q. What caused the termination of the Indiana tax credit?

A. Effective lobbying by a couple of major oil companies and the—

The Court: Let's not get into that.

A. — Well —

Q. Let's move on then.

As of July 1 of this year, the Indiana tax credit will phase out of existence?

A. That's correct.

Q. Does Indiana have a job grant program so if you locate your plant in certain areas you get certain grants?

A. They have a grant program for ethanol production provided it is located in a distressed area and has a certain number of jobs.

Q. Does that translate itself into an amount per gallon or could you do that as to what you're receiving for that in Indiana?

A. It is scheduled to be 15 cents a gallon; however, it is subject to an annual variation, so it is not preset funded.

Q. So as of July 1 of 1985, there will be no sales tax credit program in Indiana?

(p. 23) A. That's correct.

Q. With respect to the legislation that is challenged in this lawsuit, the Ohio reciprocal ethanol credit portion of the act, as a matter of law it is pointed out that it will no longer apply to out of state producers who do not have a tax credit in their state as of July 1, 1985. That's your understanding?

A. Yes.

Q. So if that law were to remain in effect, what impact would it have on your business as of that date?

A. We would, in my judgment, be insolvent. We would not be able to sell in Ohio. We are not aware of any other market of which we can sell that product so we would be unable to maintain or meet our financial obligations.

Q. Even prior to July 1 of 1985, is the Ohio Reciprocal Ethanol Credit Act having impact upon your business in Ohio right today?

A. Yes, very definitely. The law provides that for contract customers the reciprocity provision does not apply so for the amounts sold on the contract, the reciprocity

does not apply; however, to the spot sales the reciprocity would apply to out of state producers and did apply in the month of January where it was interpreted for a 30 day period of time, 31 days in January, the Ohio incentive would remain at 35 cents for those states that (p. 24) meet the reciprocity provision or those who had a contract, so therefore, any spot sales by someone who didn't meet the reciprocity; i.e. new energy, would have a 10 percent amount on the — do you understand?

The Court: Yes.

Q. To interrupt you so the record will be clear, you are saying the reciprocity provisions aren't going to apply to contract sales, you mean prior to July 1 of 1985?

A. Right. Afterwards it applies. After July 1. And would make it impossible to honor the contract.

Q. If the reciprocal ethanol credit is implemented between now and July 1 of 1985, will any of your purchasers be able to determine the price they are going to have to pay for ethanol?

A. No, because the Indiana subsidy is recalculated every month by the Ohio Tax Commissioners office and since it is evaluated on what the tax sales were several months before, because those are the only things to the Ohio department, we cannot tell somebody in the middle of the month what the subsidy will be calculated at in the next month. So there is a new entrance trying to gain market share. Once you just try to explain it, it sounds confusing. When you explain it to a retailer, we are running into a very chilling effect in terms of finding the market we need.

(p. 25) Q. Do you have any dispute with the tax department's interpretation of that law?

A. No, I think that it is a fair and correct reading of the statute.

The Court: At this point, let's take a 10 minute recess.

Recess taken.

#### BARRY DIRENFELD

Resuming the stand for further Direct Examination, having been previously sworn, continued his testimony as follows:

#### DIRECT EXAMINATION (Continued)

By Mr. Young:

Q. Mr. Direnfeld, I hand you what has been marked as plaintiff's exhibit 3 and plaintiff's exhibit 4, that have been provided to opposing counsel.

You testified earlier that you were in agreement with the positions taken by the tax commissioner with respect to this legislation. Are those letters to your company from the State of Ohio, Department of Taxation, describing how it will be implemented?

A. Yes, both of those letters are to our company articulating the interpretation. We find nothing incorrect with the state's interpretation.

(p. 26) Mr. Young: In order to demonstrate for the record the impact of the federal and state tax credits, I

have prepared some charts and we will have those marked. We will move to substitute reduced copies at the end of the proceeding.

Thereupon, the above mentioned charts were marked for the purpose of identification as plaintiff's exhibits 5, 6, and 7.

Q. I will hand you that which is marked plaintiff's exhibit 5, which has been shown to opposing counsel during the recess, and I would like you to explain that particular exhibit to the court and go through the mathematics, if you would.

A. Okay. (Indicating) What this chart shows is how ethanol is priced from New Energy's standpoint so you can see what the value of ethanol is and how we invoice it. Our cost of production is approximately net to the plant \$1.32 and that's roughly our break-even point at this moment. This will show you how, under our contracts and even on a spot basis these are the components you would use to price it on a contract. It is spelled out directly.

For example, there are three components: The (p. 27) price of gasoline, the value of the state credit, and the value of the federal credit that would determine the gross value of ethanol. So in fact, what would happen is today's price of gasoline is roughly 73 cents for wholesale.

To that you add 25 percent a gallon Ohio credit and the 60 cents a gallon federal credit to the equivalent price which is essentially \$1.58.

In order to induce a customer to use it, because they are handling the cost of putting in filters and tanks and refiller, you have to provide him a discount or increase his margin to use it. In this case it is 20 cents a gallon of ethanol. So you reduce the 1.58 and come up with a price of 1.38, and that's a delivered price of a purchase of a gallon of ethanol, and we would lay that in his terminal and we pay six cents a gallon to get it into Ohio from South Bend. So the net price we received for a gallon of ethanol sold in Ohio is \$1.32.

This today is providing us just enough revenue to cover revenue payments, it doesn't allow us anything for principal, so you see we are just in a break-even position and we will come back and talk about this number (indicating).

Q. One more thing. You started out with a net price for a gallon of regular gasoline. Is there some easy method to determine that?

(p. 28) A. In our contract we refer to the Oil Price Information Service, which is a weekly publication put out and its vernacular is OPUS [sic], and it lists every terminal in the United States that sells gasoline so either party can pick it up and look at what the average price is for that week, and from that you simply add the value and credits to get this number.

Q. I will now hand you, Mr. Drenfeld, plaintiff's exhibit 6 and I would like you to explain how the value of ethanol, as it's impacted by federal and state tax credits, provide incentive for customers and how the 90/10 blend program works.

A. The cost we had on the example is \$1.38 which is the price the customer pays to New Energy. In order to find out what his next cost is, you back off the value of the Ohio credit, subtract the value of the federal credit and you will get a net cost to the customer of 53 cents a gallon. That reflects that margin discount we talked about before.

Q. That's a gallon of pure ethanol?

A. Right. So this 53 cents is 20 cents a gallon less than the price of regular gasoline. Then in order to use that, the customer has to blend it in the 90/10 ratio that we talked about before so I illustrated how the retailer would do that.

(p. 29) What he would do is take the 53 cents ethanol from there and take 10 percent, so it is 5.3 cents per gallon.

Then take 90 percent of the price of a regular gallon of gasoline and that yields a price of 65.7 cents so when you add that together the cost of the blend is 71 cents or two cents less than a gallon of regular gasoline so this avoids an increase margin of two cents a gallon to our customers and gives them an incentive to pick up the additional cost of handling ethanol and [sic] well as handling a new product, and that is how it is priced and used and this is how it is in our contract and that's how every retailer does his economics to decide if he wants to use the product or not.

The Court: That does not include the extra cost to the dealer to do the blending process and the extra cost of equipment?

The Witness: Right, so we have to get it under gasoline.

The Court: Does the 71 cents still give enough incentive?

The Witness: Yeah. We are selling all we can make at that price.

Q. I would now like to show you plaintiff's exhibit 7 and see what impact the loss of the Ohio credit would (p. 30) have on the pricing of the 90/10 blend ethanol.

A. We go back here again to the \$1.38 gross price and give a zero price to the Ohio credit plus the 60 federal which would now give us 78 cents net cost of ethanol which is seven cents higher than the price of gas.

Q. So if you look at plaintiff's exhibit 6 you compare that to the 53 cent cost to the use of state tax credit.

A. That's correct, so instead of being below gasoline you are above gasoline. So when you take the 78 cents and blend it in the 90/10 ratio, the total cost of blend is seventy-three-and-a-half cents compared to the 73 cents of gasoline, and to which you add to the cost of handling and the customers won't do that. There is plenty of other gasoline to buy and other ethanol in the market place and he would buy from another supplier so the customer would not in any sense have any economic incentive to buy from us and they won't.

Q. In some products one might look at a two cent differential or one cent differential and say that wouldn't make any difference, but what margin are we dealing with?

A. To a retailer, just to take on the 1,700,000 gallons we are talking about selling in Ohio, two-and-a-half cents which is the difference in these two examples. (p. 31) So

that's 17,000,000 gallons of product so that's about \$34,000 per month of cost to the retailer so you are talking about a very substantial amount of money.

Q. I just have a few more questions, Mr. Dierenfeld.

Who are the other major suppliers of ethanol to Ohio consumers?

A. South Point Ethanol which is located in Ohio; Archer Daniels Midland (ADM), which is the largest supplier nationwide is located in Illinois; and Pekin Energy, which is a joint venture of Texaco and Corn Products is also located in Illinois.

Q. Did you say ADM is the largest?

A. Yes, far and away.

Q. After the Ohio ethanol reciprocity credit program was implemented, would ADM still continue to get the 25 percent credit?

A. Yes.

Q. That would be because its state still has a similar tax credit program?

A. Yes, theirs is approximately four percent of their tax program so it is well above the 25 percent level.

Q. How about the out of state supplier, would it continue to receive the out of state credit?

A. Yes, they are located in Illinois as well.

(p. 32) Q. Naturally the South Point, as an Ohio producer, would receive it?

A. That's correct.

Q. Is the value of production of ADM able to take up the 1,000,000 a month you are selling?

A. For example, their smallest plant makes 90,000,000 a year and our largest plant will go 50,000,000, so their smallest plant is two times our size, so no problem.

Mr. Farrin: Objection, he can't state as to what the capacity of ADM is. He doesn't know for instance if all of their anticipated production is already contracted for, so I move to strike that answer.

The Court: I will sustain the objection unless there is another basis.

Q. Are you familiar with ADM's current marketing efforts?

A. Yes, we are competing with them.

Q. Are they an active competitor seeking to sell volumes beyond that currently being sold?

A. They are a very active competitor.

Q. Assuming what you know about the business, do you know anyone who is out actively trying to market ethanol that doesn't have ethanol production available to meet it?

A. At this moment in the market place, it is not (p. 33) supply constraints but rather it is demand constraints.

Q. How familiar are you with ADM?

A. Very familiar. I served as vice-chairman of the Renewable Fuel Association which is the Trade Associa-

tion for all of the ethanol community users and served on the board of directors with—

Q. You discussed this problem with ADM on many occasions?

A. We discussed reciprocity and well—there are limits as to what a Trade Association can talk about generally, so we don't talk about, I'm not privy to their marketing plans or their pricing plans, or in that instance I can't speak firsthand but I am familiar with their view of the ethanol industry and their need—for example—

Q. Well, I don't want you to go into hearsay, but are you personally familiar with their ability to supply any reduced supplier by yourself in Ohio? Do you have personal knowledge of that?

A. Yes, they are able to supply markets. In fact, Mr. Young, what I can tell you, is we have joined Archer Daniels Midland in filing an anti dumping petition against Brazil because they have plowed the market place so what we have in the market place is a very large supply of alcohol so you know, therefore, the ethanol (p. 34) production people, domestic qualified producers, are able to look for and are seeking new markets wherever they can find them. Ohio, because of the geographic location and the cost of transportation, is a very good market for our competitors.

Q. Based upon the testimony that you have given then with respect to how these credits work and what's happening in the market place, if either ADM, Pekin Energy or any of the other three suppliers in Ohio pick up your supply to Ohio customers, if you are driven out of

the market, will that mean Ohio will get any more tax dollars than they did before?

A. No, simply our share of the market will simply be taken over by another competitor.

Q. The people who supply it will receive the credit?

A. Correct.

Mr. Young: I have no further questions of this witness, Your Honor.

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The Court: Cross?

What's the difference between alcohol and ethanol?

The Witness: My inner substitution of the two. Ethanol is an alcohol and in the development of the industry they became interchangeable. It is alcohol or (p. 35) ethanol and they are identically the same. I apologize for using them interchangeably.

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### CROSS EXAMINATION

By Mr. Farrin:

Q. Mr. Dierenfeld, you testified on direct examination that you have one major contract with an Ohio motor vehicle fuel dealer; is that correct?

A. That's correct.

Q. It is my recollection that you testified that that contract calls for a \$1,000,000 or 1,000,000 gallon delivery to that dealer per month?

A. Yes.

Q. With respect to that particular dealer, I would ask you whether or not it is your understanding, under the current position of the Department of Taxation with respect to the application of the current law that with respect to those, to the ethanol delivered to that particular motor vehicle field dealer, they will receive the full credit at least up until July 1 of 1985?

A. They will receive the full credit until July 1, and thereafter zero.

Q. Thank you.

With respect to Archer Daniels Midland, is that correct?

(p. 36) A. Uh-huh.

Q. I will refer to them as ADM. Are you familiar with or do you have personal knowledge of what their production costs per gallon of ethanol is?

A. No.

Q. So you don't know whether or not because of their size they would be able to undercut your company by reason of their lower production cost?

A. No, I'm not privy to their production cost.

Q. You testified late in the direct examination with respect to the impact on Ohio's tax receipts in relation to the imposition of the new statute, which is being challenged in these proceedings, that one of the other producers, but if not New Energy, will receive the credit and therefore there will be no impact on Ohio tax receipts or tax losses; is that correct?

A. In my judgment, that is correct.

Q. Just to clarify, I will ask you this question directly: Is it your understanding that credit is available to the producers of ethanol?

A. No, what the credit does is it is available to the ethanol that is produced and blended and sold in the state of Ohio. The origin of the ethanol determines the qualifications under the statute as to whether it is a qualified fuel and what the amount of the qualified fuel (p. 37) credit is under the Ohio statute. One of the determinants of what the value of the qualified fuel is the origin of the ethanol and the values that that state provides as its credit—

Q. My point was a simple one and merely to clarify the application of the tax laws. Is it your understanding that the credit is really one that is available to the motor vehicle fuel dealer who is the person who actually pays and assesses the tax?

A. It goes to the ethanol which is blended and sold by—and the tax is collected by a retailer.

Q. It was my recollection on direct examination that you testified that presently your delivery or production for delivery to Ohio is approximately 1,000,000 a month?

A. That's right.

. . .

#### BUDDY ADDIS

(p. 39) called as a witness on behalf of the plaintiff, being first duly sworn, testified as follows:

#### DIRECT EXAMINATION

By Mr. Young:

Q. State your full name, sir.

A. Buddy Addis.

Q. And would you state your address, please?

A. 416 North Main, South Bend, Indiana.

Q. What is your current employment, sir?

A. I'm financial manager, treasurer of New Energy (p. 40) Company of Indiana.

Q. How long have you served in that capacity?

A. Since September of '84.

Q. Would you give us a brief resume of your educational background?

A. I'm a graduate of Eastern Illinois University with a BS degree in accounting and currently hold a CPA certificate from the State of Illinois.

Q. What was your employment prior to your current employment at New Energy of Indiana?

A. Most recently I was employed for twenty-and-a-half years with O. S. Cereal Mill in Paris, Illinois, a dry corn mill.

Q. And prior to that?

A. I spent two-and-a-half years on staff with Peat, Marwick and Mitchell in Illinois.

Q. Would you briefly describe your duties in your present capacity at New Energy?

A. I am in charge of all of the accounting and financial functions for the New Energy Company.

Q. Do your duties in that respect include the preparation of monthly reports or analysis of the business?

A. Yes, sir, it does.

Q. What are the monthly reports that you or a more similar business would prepare each month?

(p. 41) A. The balance sheet, income statements, source and application of funds.

Q. That source and application of funds, would that be called a cash flow statement?

A. A cash flow statement is a little more detailed but we do generate cash for cash flow statements.

Q. Did I ask you prior to coming here to make certain computations as to the impact of various reactions to the enforcement of the Ohio Ethanol Reciprocal Credit Legislation.

A. Yes, sir, you did.

Q. When did you anticipate that your plant in South Bend will be ready for full production?

A. We anticipate full production in August of 1985.

Q. If one looked at your monthly statement prior to August of 1985, what would we see?

A. A cash flow wide prior to August of 1985 would be small losses, small cash flow losses.

Q. And are you making any payments on your principal at this time?

A. No, sir.

Q. When did the deed instruments call for the payment of principal?

A. The first payment on principal in our senior debt would be March of 1986.

(p. 42) Q. So I take it then you are paying interest only?

A. Interest only.

Q. Is there any reflection for depreciation yet in your monthly statement?

A. Not on cash flow statements, no; it is not on there.

Q. So without paying principal during this start-up period, you're experiencing small losses?

A. Small losses.

Q. Is that typical in a new, highly capitalized business?

A. No, that normal for businesses in start-up period.

Q. So once you reach your full production, assuming you do in August of '85, do you in the normal course of events prepare a projected cash flow statement for the rest of the year?

A. Yes, sir, I do.

Q. If there were no change in the Ohio Ethanol Legislation as it impacted upon New Energy, what would your bottom line show in your cash flow statement for August,

assuming that you produced and marketed your full product for that month?

A. My current August of 1985 projection would show a gain of about \$38,000.

Q. For that month?

(p. 43) A. For the month of August.

Q. Now what I have asked you to do is two things.

First of all, to make the assumption for that month of August with respect to the projected ethanol that would be sold in the state of Ohio that you would have to reduce the price by 25 cents per blended gallon, and if you made that assumption, because you lost the Ohio credit, that you attempted to reduce the price charged your customers by 25 cents per blended gallon or 25 cents per—

The Court: 2.5 cents.

Q. 2.5 cents per blended or 25 cents for a pure gallon, but if you reduce your price you charge by the Ohio credit you lost, did you readjust your monthly, your August monthly cash flow statement?

A. Yes, my August of 1985 cash flow statement then would show a loss of approximately \$397,000.

Q. That would be about \$397,000 per month?

A. Per month for the month of August only.

Q. Okay. I ask you then to make one other calculation. To assume that you worked out of your August 1985 cash flow statement, the production and sale of the 1,700,000 gallons of this sale of ethanol. In other words, instead of readjusting to this new law by reducing your prices

you say I won't sell in Ohio and back (p. 44) out of that your 1,700,000 gallons.

Did you do that?

A. Yes.

Q. What is the bottom line on your cash flow statement for August of '85?

A. A loss of 693,000.

Q. If you followed either course of action and found yourself in that position in the month of August of 1985, would you be able to make the interest payments on your debt instruments for the debt used to capitalize this facility?

A. No, sir.

Q. Are there clauses in your debt instruments as to what happens if you can't meet your—

A. Right, we would reach a default and all of the nastiness that follows a default. The bankruptcy and—

Mr. Young: I have no further questions of this witness.

\_\_\_\_\_  
The Court: Cross?  
\_\_\_\_\_

## CROSS EXAMINATION

By Mr. Farrin:

Q. Mr. Addis, in these calculations or projections that you were asked to make by Mr. Young, did you pre-

pare (p. 45) anything in writing that detailed these calculations?

A. Yes, sir, I did.

Q. Do you have those with you today?

A. Yes, there were furnished to counsel.

Q. Would you tell me in your projections for the future without the credit of without the sales, these losses were projected I take it at, assuming the same production costs you have now?

A. That's true.

Q. You didn't take into consideration the possibility that there could be a reduced production cost?

A. Reduced production cost will come after the plant is beyond start-up stage and in full production. We anticipate possible savings in production because of—

Q. In Mr. Young's question he first stated anticipate full production. You indicate you anticipate full production in August of '85.

A. That's correct.

Q. Which seems to come within the period to which you are projecting?

A. Right.

Q. So you have stated it is possible within full production that you have reduced projection costs?

A. That's the same thing as me assuming production prices. I must work with what I have, what is guaranteed.

(p. 46) Q. That's my question. You are making assumptions based on current figures and not possible changes over the time period.

A. Excuse me, but these were entered as forecasts.

Q. That's what I am trying to clear up. These are not based on anything other than presumptions as to future—

The Court: I don't think we need to belabor this point but I don't think the figures are relevant. Whether they are a million or half a million off, I don't think that's relevant to the issues in this case. If you want to go into it, you can.

Mr. Farrin: Your Honor, very briefly then.

Q. I take it these projections would also differ if for instance we had a huge gasoline increase in the near future, like we had several years ago.

A. Increase in price?

Q. Yes.

A. Certainly.

Mr. Farrin: No further questions.

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The Court: Did you prepare similar figures for the Indiana Legislature and the effect of their legislation?

The Witness: No, sir.

(p. 47) The Court: What has the Indiana Legislation cost the company? Projected in 1985?

The Witness: Projected in 1985, I don't think there would be a cost there that would affect us.

The Court: You are cut out of the credit and that has to have cut the company's Indiana sales, doesn't it?

The Witness: No, because everyone loses that, not just the New Energy company of Indiana.

The Court: Doesn't that put you in the same class?

The Witness: No, Indiana and Illinois.

The Court: No. In trying to be competitive with gasoline, once the credit goes off, it is difficult to compete for the 10 percent of ethanol other than gasoline; isn't that true now in Indiana?

The Witness: That may be possible but I think not.

The Court: Well, do you know if Indiana is going to change or has changed from its 30 or 35 percent figure with its credit off, whether that's anticipated to go down, the 35 percent figure possibly going down to zero?

The Witness: The 35 percent?

Mr. Young: They don't have the tie-in to the tax provision like Ohio does, Your Honor. Is that what you are talking about?

(p. 48) Mr. Farrin: The credit is going to be repealed as of July of '85 completely.

The Court: But I am speaking about the projected figure with the repeal of that as to the effect in Indiana. I thought there was a statement that at 30 percent or 35 percent Indiana has the highest use of ethanol in the country. Isn't that what was said?

The Witness: Yes, that's the Indiana usage of gas with ethanol; yes.

The Court: That's what I am saying. With the Indiana tax being cut off in July of 1985, did you do any anticipated projections of revenue post July 1 of '85 of the loss of dollars in Indiana as a result of the Indiana Legislation?

The Witness: No, sir.

The Court: Okay.

Mr. Young, do you have anything further?

#### REDIRECT EXAMINATION

By Mr. Young:

Q. What the judge is trying to point out, although I haven't asked you to project it, isn't it a fact as he was questioning you that in Indiana, in the future, assuming nothing happens to that Indiana Legislation and it can't be changed from now and the effective date. The (p. 49) people who sell gasoline there take a greater production of the market away from ethanol use because ethanol can't be competitive with them?

A. Yes, sir.

Q. So it is only natural to assume that what will happen in Indiana, the ethanol production that is enhanced by these credits will go down and sales of regular gasoline will go up?

A. Yes.

Mr. Young: That's why we brought up who lobbied for the legislation.

The Court: I understand.

Anything further?

### RECROSS EXAMINATION

By Mr. Farrin:

Q. Mr. Addis, in light of the questions by Judge Crawford and by Mr. Young with respect to the effect of the repeal of the Indiana credit, you stated you haven't done any specific study on it. Could you give your opinion of the effect of it on the vitality of the company, assuming that Indiana credit is—or accepting the fact the Indiana company is—or the Indiana company will be repealed in whole out of July 1, 1985?

A. I really have nothing to base an opinion on (p. 50) for what would happen.

The Court: You made a statement that with Ohio's Legislation as of August of 1985, you can project a monthly loss of \$370,000,000. Is included in that figure a supposition that you are also going to lose money because the percentage of the 25 percent or whatever that are taking place in Indiana?

The Witness: No, sir.

Q. So what you are saying is the company, as a result of Indiana and Ohio, are going to be in a position—first of all I can't tell by your figures how you can even exist under Indiana's situation even if Ohio didn't change because you are going to lose money as of July as a result of Indiana, but the combined two—

A. Well, as counsel pointed out we hope as the planning goes on the efficiency of the plant and learning how to come up with better yields produce enough to come up by the time 1986 comes.

The Court: But you will lost customers in Indiana so you will have to sell more gas not only keep the gas that you have in Ohio and Illinois, but sell more gas to make up for the loss in Indiana which may not be projected in those figures.

The Witness: That's true.

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(p. 51) ROBERT E. REYNOLDS

called as a witness on behalf of the plaintiff, being first duly sworn, testified as follows:

### DIRECT EXAMINATION

By Mr. Young:

Q. State your name.

A. Robert E. Reynolds.

Q. What is your employment?

A. I'm the marketing manager for New Energy Company of Indiana.

Q. How long has that been your position?

A. I joined them in October of '84.

Q. In order to qualify you to answer some of the questions I will put to you, I would like to ask about your prior employment prior to that time?

A. Immediately before that I was a special field manager for the Southland Corporation with Petroleum (p. 52) Products Division.

\* \* \*

(p. 53) Q. Were you able to, in that capacity, to make (p. 54) observations with respect to what impact the change in a state ethanol tax credit law would have upon production or sales in a given state?

A. Yes, it was my job to determine market entry and market exit for ethanol blending.

Q. While you were serving in that capacity, did you have an occasion to see the discontinuance of, for example, of sales or production in a given state because of a change in ethanol credit laws?

A. Yes, in the state of Texas.

Q. What happened there?

A. The legislation was changed such that the exception was different in each quarter and caused a roller coaster effect. We couldn't determine what our buying price would be for the ethanol we were using to blend so we had to exit the program because of our inability to plan.

Q. So you discontinued then using ethanol in the state of Texas?

A. That's correct.

Q. Comparing that if you will with the situation that exists in Ohio during the period from January 1, 1985 until July 1 of 1985, where the credit with respect to the Indiana procedure will be variable each month, what impact does that have on the ultimate buyer of ethanol in Ohio?

(p. 55) Mr. Farrin: Objection. He's testifying from the standpoint of purchasers of ethanol and I don't believe he can speculate as to what, I don't believe he should be able to speculate as to what consideration they will give to this possible fluctuation of credit they will receive.

The Court: I will let him answer the question. You can cross examine him.

Q. You were the largest independent purchaser of ethanol in the United States?

A. That's correct.

Q. What impact then, based upon your personal experience, does a law which would require this fluctuation each month in the amount of credit have?

A. I would be reluctant to buy if I could not determine the sale price and exemption that I would get from a certain producer.

Q. But would you make any demand of the producer?

A. As a matter of course when I was at Southland we required written certification that if there was any loss of the tax exemption that we would be reimbursed by the supplier of the ethanol.

Q. Okay. Have you had any actual contacts from customers in Ohio subsequent to the enactment of the Ohio Legislation in that respect?

A. Yes, we have had some customers request that (p. 56) we—

Mr. Farrin: Objection, hearsay.

The Court: What's the purpose of the testimony?

Mr. Young: To demonstrate what impact this Ohio law is having on their ability to market in the state of Ohio.

The Court: Are you trying to get it in for the truth of the matter stated?

Mr. Young: No. If he has received a demand from the customer, the mere fact he received a demand from the customer seems to me would be relevant in this case? Why the customer made the demand—

The Court: I'm not saying it is not relevant, I just want to know why it isn't hearsay.

Mr. Young: Because it's just simply showing he has received demands from the customers.

The Court: Have you received demands from customers?

The Witness: Yes, I have.

Q. (By Mr. Young) Relating to the Ohio Legislation?

A. Yes.

Q. With respect to the period of time when you were a purchaser of ethanol, how important was the reliability or continued existence of a given producer to the subject of your willing to enter into contracts with him?

(p. 57) A. It's extremely important.

Q. How does that relate to the problem at hand with respect to the Indiana producer trying to sell in Ohio?

A. I would say the customer feels that we cannot survive selling at a price reduced—

Mr. Farrin: Objection, he is again speculating.

The Court: Sustained.

Q. I want you now to speak only of the situation when you were a buyer and the consideration you gave to the purchase of ethanol while you were a buyer.

Now, did the problem ever arise where there was some question as to the ability of a given producer to continue to serve your needs?

A. Yes.

Q. When that problem arose, what was your natural reaction as a buyer of ethanol?

A. To either seek a more stable supplier or to withdraw from the program.

Q. Now are you responsible for trying to market ethanol for New Energy of Indiana?

A. I am.

Q. And has the enactment of this Ohio Legislation created a problem for you in attempting to market it in Ohio?

A. Yes, it has.

(p. 58) Q. And what does the problem relate to?

A. There is concern that we will not be able to stay in the market place after July 1.

Q. Okay. Let's turn to the question that was asked by the court because it is a very real question here.

Mr. Direnfeld testified to a projected distribution of ethanol to Ohio to the tune of 35 percent of its total output.

A. That's correct.

Q. That it does have one very major contract customer.

A. Yes.

Q. Do you have any contract customers in Indiana?

A. No.

Q. Okay. So what percentage of your overall production is sold in Indiana?

A. Approximately 15 percent max.

Q. Okay. So the balance is sold primarily in Illinois and Ohio?

A. Yes.

Q. Now come July 1, 1985, when there is no longer the credit in Indiana—

A. Yes.

Q. —isn't it a fact that although it will affect all the other producers the same that your position via (p. 59) the regular gasoline distributors will be harmed?

A. I'm sorry, I don't understand the question.

Q. In other words, when you lose, when you consider the pricing formula that was identified by Mr. Direnfeld, when you lose that edge in Indiana, the credit—

A. Yes.

Q. —won't it be more difficult to price your product competitively with gasoline after you lose that credit?

A. Yes.

Q. What will New Energy have to do in order to stay alive if there is an inroad in that 15 percent production?

A. We would have to redistribute to other markets.

Q. So in other words you will need to sell more in Ohio and Illinois rather than less?

A. Yes.

Q. Okay. Now in terms of a suggestion that once you lose your credit in Ohio and we are speaking of a different problem, your competitive position via the other suppliers of ethanol who will continue to receive the credit—and when we talk about Indiana we talk about everybody's market position hurt—how far can you go in terms of the distribution of your ethanol product without running into transportation cost problems?

A. We basically can't exceed the three state market (p. 60) we are in now; Indiana, Ohio, and Illinois, before it becomes prohibitive.

Q. The freight becomes prohibitive?

A. Yes.

Q. Let's assume you want to go to Kansas. What kind of freight would we be talking about?

A. To Kansas, 12 to 14 cents minimum.

The Court: How about Michigan?

The Witness: To get to a major metropolitan market would be 12, 12 to 14 cents.

The Court: Same as Ohio?

The Witness: Yes.

Q. (By Mr. Young) Do you market in Michigan yet?

A. There is only a one cent exemption so the formula is different and it is below our capability to market at that price so we do not sell in Michigan.

Q. So as to confirm the question asked by the court as to the impact of the Indiana law.

A. That's correct, we have less than a fraction of a percent of sales in Michigan and we can't sustain sales in Michigan.

Q. So you have to increase your sales in both Ohio and Illinois or a very close state?

A. Or a very close state, yes.

• • •

(p. 63) Q. Would it be your opinion that the loss of the approximate 15 percent market of your product in Indiana would be a severe detriment to the ability of the company to survive?

A. If we did not have an alternative market to go to someplace with it, yes.

Mr. Farrin: I have no further questions.

### REDIRECT EXAMINATION

By Mr. Young:

Q. In terms of the questions about limited demand, what has been the gross in the last 12 years in the ethanol market and then tell me what all of the national publica-

tions are projecting in terms of next year's growth in the market?

A. The market has increased to roughly 500 gallons of ethanol a day.

Q. Tell me last year what percentage of increase there was?

A. I can't tell you exactly but it was approximately 15 percent. Future demand, because of lead phase down pending through the United States Environmental Protection Agency indicates there would be increased demand for ethanol as a replacement for lead gas, all lead.

(p. 64) Q. So you anticipate the potential for increased markets?

A. Yes.

Q. In Ohio and Illinois there currently is a bar against further import of Brazilian ethanol?

A. In Ohio, yes.

Mr. Farrin: That's a legal question, Your Honor. I object.

Q. I don't want you to tell me what the law is. Are the Brazilian producers importing any additional ethanol currently to Ohio or Illinois?

Mr. Farrin: Objection, Your Honor.

A. No.

Mr. Farrin: He hasn't laid a foundation for the witness to answer that question.

The court: Overruled.

A. No.

Q. Then what is the projected increase in the demand for ethanol next year, approximately?

A. Approximately 10 to 15 percent.

Mr. Young: I have no further questions, Your Honor.

The Court: Anything further?

Mr. Farrin: Nothing further, Your Honor.

(p. 65) The Court: That's assuming the oil lobbyists don't go out and start knocking off one state at a time and knocking out tax credits, right?

The Witness: Yes.

The Court: All right.

Mr. Young: Your Honor, at this time, we would like to offer into evidence plaintiff's exhibits 1 through 7.

The Court: Any objection?

Mr. Farrin: No objection, Your Honor.

The Court: They will be admitted.

\* \* \*

# TRANSCRIPT OF PROCEEDINGS

March 29, 1985

(p. 4) BARRY DIRENFELD

called as a witness as on cross examination, being first duly sworn, testified as follows:

## CROSS EXAMINATION

\* \* \*

Q. Are you familiar with Indiana Public Law 11-1984 which has been codified as Indiana Code 4-4-10.1? It is commonly referred to as the Ethanol Fuel Production Incentive Grants Program?

A. Yes.

(p. 5) Q. Could you tell me your understanding of how that program works?

Mr. Young: Your Honor, for the record I would indicate an objection. We went into this, we started into this the last time and the court indicated it wasn't too interested in what happened in Indiana so we technically object; although on the other hand, we feel it demonstrates the retaliatory nature of the Ohio law, so if the court wants to hear it, fine, but we want to indicate an objection for the record on the grounds of relevance.

\* \* \*

(p. 6) Mr. Young: I think the court is correct, but I (p. 7) don't want Mr. Farrin to indicate it was Mr. Direnfeld's—

The Court: Go ahead.

Q. (By Mr. Farrin) I will repeat the question, Mr. Direnfeld.

What is your understanding as to how that incentive program works?

A. In terms of its implementation?

Q. Yes.

A. My understanding is that the state has established a fund which is subject to an annual review, an annual appropriation process, and it establishes a mechanism for which an entity who's an eligible producer may apply for and receive a grant provided that producer has constructed an ethanol plant that creates a significant number of jobs,—and I think the number is 75 or 100, whatever the number might be—of jobs in a blighted area as formerly designated by the state and if that's the case that entity is then able to apply or eligible to apply to the State Department of Commerce who administers the grant, and you have to apply with a poster of the number of employees that you have. A certification as to the fact that it is in fact a blighted or formerly blighted area, that you have created the requisite number of jobs for the statute and in that case you become eligible to receive a grant.

The grant on its face created a 25 cent per gallon (p. 8) measurement in terms of magnitudes of how much they want to in terms of appropriate an amount to eligible entities.

In fact, however, the first year they decided that even though, because they have an annual appropriation pro-

cess, they appropriated only \$4,000,000 rather than the 13 they authorized, and said the grants would be at the rate of 10 cents rather than 25 cents for that year.

Those grants are eligible to any producer, ethanol production facility that qualified and it goes on a first come, first serve basis. Each month you must formally apply, state all of the certification I went through and in which case you would be eligible to receive, in this calendar year for example, 10 cents a gallon up to the expenditure of \$4,000,000 of state funds.

Q. Am I correct in understanding New Energy is an eligible entity under that program?

A. Yes, we applied for the grant and have been determined by the Department of Commerce to be eligible.

Q. Do you have personal knowledge as to whether any other, there is any other entity that has qualified for this program?

A. No, I don't.

Q. Are there any other ethanol producers in the state of Indiana that have plants located in the state of Indiana, to your knowledge?

(p. 9) A. No.

Q. So I can assume you are the only one who could qualify under the terms of the grant program?

A. I don't know, there are a lot of newspaper articles as to—there is a plant in—

Q. Please, just answer it.

A. You asked for my personal knowledge if anyone else applies and I don't think so.

Q. My question is, if the program is solely for ethanol and physically located in Indiana, there are no others—

A. To my knowledge, our entity is the only one who so far has been declared eligible.

Q. Thank you. And are you currently receiving grants under the program?

A. Yes.

Q. Now under that program, am I correct in my understanding that for each gallon of ethanol produced by New Energy, regardless of where it is shipped to, if it is used in Indiana or shipped to Ohio to blend in the making of alcohol, that you currently receive the 10 cents per gallon credit or grant?

A. Correct, it is a manufacturing grant.

Q. And the grant, does the grant, the price per gallon grant or the amount per gallon grant increase after (p. 10) July 1 of 1985?

A. I don't know the answer to that. On the statute it was to be 25 cents this year—

Q. Under the current statute?

A. No, I'm telling you under the current statute it was to be 25 cents per gallon this calendar year and in a rider that was put on the end, they decided to make it 10 cents this year. Under the statute again for the next year it would be 15 cents if you followed the face of the statute.

Q. That's all I'm asking.

A. No, but that's an important point because no money has been appropriated for the next year and I don't know what the level is going to be.

Q. But under the current statute the way it is now written, it goes up to 15 cents after July 1, 1985?

A. That's right, the current statute is 25 cents currently funded at the rate of 10, going 15 on July 1.

Q. Thank you. So currently New Energy is receiving 10 cents per gallon for ethanol, including that which is shipped to the Ohio dealers for the making of alcohol?

A. It is everything we have manufactured again.

Q. To your knowledge, are your customers in Ohio, that is motor vehicle fuel dealers in Ohio, currently receiving an Ohio credit for each gallon of ethanol that (p. 11) you distribute to them that they in turn use in making gasohol?

A. Yes, although it is in varying amounts.

Q. Do you have personal knowledge of what that amount is for the current month?

A. Yes. No, I don't. Well, the current month I believe is 22 cents or maybe 23 cents.

Q. If you don't know—

A. Somewhere between 22 and 24 cents except for my contract customers in which case pursuant to the Ohio statute it is 25 cents.

Q. So for all your contract customers. They are currently receiving the full Ohio credit?

A. That's correct.

Q. Do you have knowledge or an estimate of the percentage of your current shipments to Ohio dealers with which you have a contract?

A. Relative to my total production?

Q. Your total distribution in Ohio, what percentage of those total distributions in Ohio are to contract customers?

A. It would have to be an estimate. Approximately, oh, more than half, so probably 75 percent or something like that.

Q. Thank you. So to make it clear to the court (p. 12) let me summarize: you currently, for every gallon of ethanol that is produced by New Energy that is distributed or sold to Ohio motor vehicle dealers, New Energy receives a 10 cent grant from Indiana and the dealer receives an Ohio credit in the range of 22 to 24 cents for that gallon; is that correct?

A. For a non-contract.

Q. For non-contract?

A. That's correct.

Q. And for contract it is the 10 cent grant plus the full 25 cent credit currently?

A. Who receives it?

Q. The 10 cent grant.

A. To me, it does not go to the Ohio customer.

Q. No, I'm talking about the total credit for grants given for each gallon of ethanol produced. You receive 10 cents for each gallon under the Indiana grant program; is that correct?

A. Oh, yes.

Q. And your dealer to whom you deliver gets—

A. 25 cents, so he gets 25 cents and I get 10 cents.

Q. Assuming first of all that there was no Ohio reciprocal provision under the current law, after July 1 of 1985. Is it correct that New Energy would be receiving, at least under the current Indiana provision, 15 cents per (p. 13) gallon of ethanol produced?

A. Provided—well, that would be dependent upon what the appropriation is and would also then be further dependent upon what New Energy's production rate is for the current year.

Q. What I'm saying is under the current law that provides—

A. The current law doesn't provide any appropriation so what the current law says is you may spend up to \$35,000,000 to any qualified producers and they can pay out at the rate on its face of 15 cents per gallon; however, it is subject to whatever they want to appropriate. So for example if they provided \$4,000,000 like they did this year and I produced \$52,000,000 of capacity, then 15,000,000 gallons produced at the rate of 15 cents might only cover, if you averaged that out, it is substantially less than 15 cents. The answer is, I'm not being coy, I don't know.

Q. If they appropriate the sufficient funds you receive 15 cents?

A. Yes, if they appropriate 15 cents, then yes.

Q. Absent in Ohio reciprocity provision, the dealers to whom you distribute in Ohio will receive a 25 cent credit per each gallon they use in making gasohol?

A. That's correct, provided Ohio—yes.

\* \* \*

(p. 15) Q. I want to make sure I understand exactly what it is New Energy is complaining about in this case. If I understand that, your complaint is limited to simply the reciprocity provision of the Ohio statute; is that correct?

A. That's correct.

Q. You are not making any challenge or any objection to the credit provision of the Ohio statute?

A. That's correct.

Q. And if I understand also your complaint, you are (p. 16) not contending that Ohio has prohibited, absolutely barred in some fashion, New Energy from selling its ethanol in Ohio; is that correct?

A. Barring by regulation?

Q. Yeah, said you can't sell in here.

A. Economically, the implication says yes but not on its face.

Q. They haven't said that you simply can't sell?

A. Not on its face.

Q. You are complaining about the effect of the reciprocity provision?

A. Yes, the effect is I can't sell.

Q. In fact if we look beyond your company, you would agree with me that the Ohio statute doesn't prohibit the sale of ethanol produced in other states other than Ohio in Ohio; does it, sir?

A. No, it doesn't prohibit it.

\* \* \*

(p. 19) Q. Let's move on and talk just a little bit about ethanol. There are several benefits that result to the public from the use of ethanol blended with alcohol; are there not?

A. Yes.

Q. As a matter of fact when I got to looking through the exhibits that were used at the last hearing, your exhibit 2, there are several of those benefits listed in that exhibit; is that correct, sir?

A. Oh, yes.

Q. I wonder if you would just flip to what is page two, "performing for the 80's", do you see that?

A. Sure.

Q. Under "increasing profits" there are three or four things listed. Do you see those?

A. Uh-huh.

Q. I take it that you would agree that the use of ethanol when blended with gasoline increases the octane (p. 20) rating of gasoline by three points?

A. Right.

Q. And by doing that, that would extend the gasoline yield from each barrel of crude oil that we use?

A. Right.

Q. And I take it you would also agree that ethanol is the cost—and I think “the” is in all caps—the cost-effective replacement for lead as an enhancer in gasoline, and you would agree with that?

A. In our judgment, sure.

Q. Well in your judgement.

A. Yes. I’m sure if someone was selling something else they would say in their judgment it would be something else.

Q. I think you told Mr. Young on direct examination that you thought ethanol was the most environmentally benign substitute for alcohol in gasoline?

A. That’s my judgement.

Q. And I take it you would agree that there are major health benefits to the public from the use of ethanol incorporated in gasoline as opposed to the lead; wouldn’t you, sir?

A. Yeah, I would.

Q. And I take it that you would also agree with me, wouldn’t you, sir, that the use of ethanol as an octane (p. 21) enhancer and substitute for lead, that to encourage that use, that’s a reasonable goal for both the Federal Government and the State Governments?

A. I believe that to be so.

Q. And that’s true in regard to each of the benefits contained therein in exhibit 2 that you and I just talked about?

A. I think absolutely, I think that it is reasonable for the government to encourage the use of surplus agricultural waste to develop renewable energy in an environmental fashion, sure.

Q. Recently the EPA has concluded that lead has to be gotten out of gasoline much more quickly than originally recommended?

A. Correct.

Q. And it is a benign substitute for that?

A. In my judgment.

Q. You would agree that’s a reasonable health benefit that both governments, state and local, ought to be encouraging?

A. I think so.

Q. As I understand it, both the Federal Government and I think you said 32 state governments have tax credit programs, credits to the retailer, as we discussed, to give incentives for the use of ethanol blends with gasoline; (p. 22) is that correct, sir?

A. Right.

Q. I think you probably would agree with me that the best way to do that is to give tax credits to those retailers?

A. Not necessarily. That’s the way it has been generally used.

Q. That's the way both the Federal Government and at least 32 states have tried to encourage that use; is that correct?

A. Tax exemptions, yes. Frankly the Federal Government, there's been a wide array on the Federal Government's side. They have been—

Q. Wait, I don't think—

Mr. Young: Excuse me, if you ask a question, David, don't cut him off in the middle of the answer.

The Court: Mr. Young, however, there was no question pending when this witness was answering. Let's not have him offering answers to questions that are not pending.

Mr. Young: Then shouldn't he ask the court instead of interrupting the witness, Your Honor? I think that's the appropriate way.

The Court: Yes, it would be. Go on and ask the question.

(p. 23) Mr. Crago: Thank you, Your Honor.

Q. I don't have an easel so I will hold this here so we can all look at it. This was marked as exhibit 5 in the first hearing, correct?

A. Uh-huh.

Q. Either prepared by you or someone in your company?

A. Right.

Q. I just want to be sure about a couple of points. First, the price calculations and the return to New Energy

as shown on this chart, as I understand it, it is based on a contract that you had to sell a million gallons a month?

A. That is correct.

Q. Of ethanol to an Ohio blender; is that correct?

A. That's correct.

Q. And this calculation includes—

A. This calculation—

Q. Just a second, I'm asking the question.

A. I'm answering your first question. What that does, that chart is an illustration of how a contracting pricing formula would work. It does not represent an exact pricing formula under our contracts which, for confidential reasons, we did not disclose.

Q. You might make more or less than on here?

A. It may be different than what is on our contract, (p. 24) that does not replicate our formula.

Q. But this formula—let me back up a second then because I did misunderstand and forgive me, but I was relying on the transcript. I understood your earlier testimony to be that the price you were receiving in the market today—

A. Correct.

Q. —In Ohio was \$1.32 a gallon net to you.

A. That's correct.

Q. And that is your—

A. At that day.

Q. The price has gone up since then; hasn't it, sir?

A. That's correct.

Q. This calculation though that shows a break even point without being able to cover depreciation expenses, as I understand it, and without being able to pay principal debt service, included a 25 cent credit from Ohio?

A. That's correct.

Q. My question to you then, sir, is under that calculation shown on exhibit 5, even with the Ohio credit, you can't pay all your obligations; can you sir?

A. I would be able to break even on my current obligations. I have no principal obligations at this moment, no.

Q. Until March of '86?

(p. 25) A. Right, so between now and March of '86 there has to be a change in market conditions.

Q. But you couldn't pay your principal even if you got the full credit.

A. If market conditions didn't change.

Q. Now in the calculations you talked about in your earlier testimony, you came up with a cost for your ethanol of \$1.32 I think a gallon; is that correct? Do you want some—

Mr. Young: \$1.38.

Q. Cost of ethanol production—again, I'm referring to exhibit 5. Cost of ethanol production is approximately \$1.32 a gallon.

A. Net F.O.B. the plant.

Q. What does F.O.B. mean?

A. It would be the plant gate price. After I have backed out transportation cost, it is the price I would sell it for if someone were to pick it up in a truck at my plant.

Q. So I can understand how you got to \$1.32, if I took all the costs you had incurred—

A. Uh-huh.

Q. —except for depreciation and principal, so all of these costs at the end of the month—

A. Uh-huh.

(p. 26) Q. —whatever that number is—

A. Yes.

Q. —and divided it by the number of gallons you produce of ethanol only—

A. Uh-huh.

Q. —that would come out, at least at the time you did this chart, to \$1.32?

A. No, that's based on a full production run which would probably be in the month of June. At this rate our cost of production is substantially higher because we are still in the start-up phase.

Q. Is there anything else that you have deducted from your total cost before you divide your total production into that? Anything else you have taken out?

A. I don't understand the question.

Q. Well I understand that you weren't factoring depreciation or principal payments. Anything else you didn't include?

A. No.

. . .

(p. 30) Q. Mr. Farrin asked you some questions about Indiana's grant program for ethanol produced in Indiana. If I understood, after you got all through there, you are presently getting 10 cents a gallon for every gallon of ethanol you produce?

A. That's correct.

Q. And it is scheduled to go to 15 cents in July but you don't know if they are going to fund that or not?

A. That's correct.

Q. If I also understood correctly, the Indiana grant program as you explained it was adopted specifically to encourage the development of a local ethanol industry; is that correct, sir?

A. And create jobs in blighted areas and create industry which would have spinoffs. There is a preamble that I can get and read to you.

(p. 31) Q. You would agree whatever, the preamble says is the purpose the legislature had?

A. To do what the preamble said.

Q. And I take it those things you reviewed for me and are in the preamble, those are legitimate purposes for the legislature to have when they adopted this; would you say that, sir?

Mr. Young: We are not here to argue about the legislation in Indiana and we would be glad to go there and argue it, but that is not the issue in this case.

The Court: Sustained.

Q. Would you also agree with me, sir, the same statute to abolish tax credits for retailers and blenders in Indiana is the same bill that provided the credit for Indiana producers of ethanol?

A. The grant?

Q. The grant, that's correct.

A. There is the production grant incentive and they were melted together, yes, they amended different parts of the statute. I think it was a two-part bill.

Q. And then put into one bill?

A. I think so.

Q. That grant was enacted, I believe you told Mr. Farrin, in 1984?

A. Correct, I believe in March but I could check the (p. 32) date of the enactment.

Q. 1984 is sufficient for me. My understanding of the earlier testimony was that the construction of your facility in Indiana began in 1982?

A. That's correct.

Q. So the grant program, to encourage the things we have talked about, was enacted two years after you began construction and a few months before you began production.

. . .

Q. (By Mr. Crago) Can you tell me some of the identities of the principal competitors you have in ethanol production?

A. Oh, yes. I would say they would be Archer Daniels Midland, Pekin Energy Company, A. E. Staley.

Q. A. E. Staley?

A. Correct, South Point Ethanol and the Government (p. 33) of Brazil.

\* \* \*

Q. Can you tell me where the—I know where South Point is located, that's here in Ohio. Where is Archer Daniels Midland?

A. Principally in Illinois. I think they have one in Iowa as well.

Q. How about Pekin?

A. Illinois.

Q. And A. E. Staley?

A. Their facility is in Tennessee, headquartered in Illinois.

Q. Sir, given the locations that you have just given to me, I take it would be fair for me to say that none of those competitors, Archer Daniels Midland, Pekin, (p. 34) A. E. Staley, or South Point qualify for the Indiana grant program?

A. Oh, I would say that's true since none of them produce in the State of Indiana nor are they located in a blighted area in Indiana so I'm sure they wouldn't.

Q. Based on what you told Mr. Farrin, wouldn't you also agree with me, sir, that after July 1, Indiana will no longer provide any incentive?

A. That's correct.

Q. To the use of ethanol?

A. That's correct, it is scheduled to go to zero.

Q. I take it you would agree with me, sir, that Ohio, through its credit program, is going to continue to provide incentives to the use of ethanol that blends with gasoline?

A. According to the statute, yes.

\* \* \*

I take it you would also agree with me, sir, that the Ohio statute, including its reciprocity provision, doesn't provide any protection for Ohio ethanol producers from producers located in states that have credits; is that also correct?

A. Protection from?

Q. Correct.

(p. 35) A. Does it adversely affect the amount of the credit?

Q. Let me ask it this way—

A. No. I'm serious because it depends on what the credit is for the location of the other producers.

Q. Let me ask it specifically. You gave the the names of four people.

A. Right.

Q. Archer Daniels Midland, they get the full Ohio credit?

A. Depends on which plant.

Q. That comes out of Illinois?

A. No, one of their plants in Illinois is gas-fired and they would not qualify. Their Iowa plant probably wouldn't qualify and their Peoria plant probably would qualify.

Q. The Illinois plant that is gas-fired, that's not because of the reciprocity provision?

A. No, it is because of the coal-fire provision within the statute.

Q. How about Pekin?

A. Pekin, in my judgment, would qualify. I think they have coal-fired.

Q. How about A. E. Staley?

A. A. E. Staley would qualify, I believe, yes, I (p. 36) think they would.

Q. And I take it you would agree with me if those entities compete with you, they also compete with South Point Ethanol?

A. I would think so, yes.

\* \* \*

(p. 38) Q. Let me try one more. Do you know whether or not the intervener, South Point, is one of the

parties that (p. 39) lobbied through the reciprocity provision in the Ohio legislation?

A. Yes, I do.

Q. How do you know whether they lobbied that through or not?

A. I'm aware from both direct conversations with representatives of South Point as well as one of the people we had watching the legislation told me.

Q. The gentleman here today representing South Point, do you know whether or not he is an officer with South Point?

A. I believe he is the general manager of South Point.

Q. Did he personally concede to you that he had helped lobby through this Ohio legislation?

A. Yeah, he had told me the reasons why they were lobbying so heavily for it is so they would put pressure on Indiana and perhaps me to lobby for some number in Indiana for them at the pump.

Q. Do you know whether or not you competitors are now trying to lobby a similar reciprocity provision in the State of Illinois?

A. Yes, legislation has been introduced with the same type of language Ohio just passed and it is being introduced by the representative of the—

(p. 40) Mr. Crago: I will object to legislation in Illinois.

Mr. Young: They first brought it up, it seems to me.

The Court: I said it before and I will say it again. I don't see the relevancy of who lobbied what or where. We are dealing with a piece of legislation and not the motivation of the people getting the legislation but we are dealing with whether the piece of legislation in the state of Ohio is constitutional or not. Let's not try and point the finger at who got it done. It is done.

Mr. Young: Okay, Your Honor.

Q. Is there any question inasmuch as you told me the 10 cent grant program in Indiana was factored into all of your calculations about which you testified to at the last hearing, is there any question but that if this reciprocity legislation in Ohio remains on the books that you will not be able to continue to supply your major contractors in Ohio?

Mr. Crago: Objection, leading.

The Court: Overruled.

A. There is no question, that is correct. I will not be able to do that if it is in effect. It is in effect but come July 1 on that contract I will not be able to do it.

• • •

(p. 41) Q. You were asked a question about other grant programs and perhaps my objection was improper because I think the question was only about state grants and you started talking about federal programs. Are there indeed federal programs that provide grants as distinguished from credits with respect to ethanol?

A. Yes.

Q. Tell me about them.

A. Well, there are two that bear really on our project. The first is a program administered by the (p. 42) Department of Energy which is a feasibility study grant program which is helpful in designing technology. They funded in our case 1.7 million dollars of our grant to help develop the technology and engineering of our facility. In addition to that, another grant available for this project, because of its impact both on the materials of agriculture and creating jobs in blighted areas and for minorities, was a urban action grant and it was giving a 9.9 million dollar development grant from the Department of Urban Development.

Q. You were asked to identify your competitors and I want to ask you one question about that.

With respect to South Point who you identified as a competitor, who is the major competitor of South Point?

A. Ashland Ohio.

Q. Do you have an automatic source of supply for Ashland gasoline stations?

Mr. Crago: Objection.

The Court: Sustained.

Q. Do you, of your own knowledge, know whether Ashland has any various ethanol supply arrangements with your two major other competitors being Pekin and ADM?

Mr. Crago: Objection, I don't know how that's relevant.

A. I don't know—

(p. 43) The Court: Sustained.

Q. Now with respect to Pekin, your other major competitor, do you know who owns Pekin?

A. I think the majority interest is owned by Texaco USA and Corn Products.

Q. And Kentucky Agriculture which is the ethanol supplier in Kentucky?

A. They are owned 75 percent by Chevron USA.

\* \* \*

#### LAUREN HILL

(p. 45) called as a witness on behalf of the defendant, South Point Ethanol, being first duly sworn, testified as follows:

#### DIRECT EXAMINATION

By Mr. Crago:

Q. State your name, sir.

A. Lauren L. Hill.

Q. Where do you live?

A. Russell, Kentucky.

Q. Where is Russell, Kentucky?

A. Right across the river from Ironton, Ohio, in fact I can see Ironton from my window.

The Court: Is that about as good as my view out here?

(Laughter).

(p. 46) Q. Who do you work for?

A. South Point Ethanol.

Q. And what is your position there at South Point?

A. I am the general manager of South Point Ethanol.

Q. How long have you had that position?

A. For two years.

Q. Mr. Hill, I wonder if you can tell us briefly some of the responsibilities you have as general manager of South Point.

A. I report to a management committee made up of representatives of partners who own South Point Ethanol and under their direction I perform all of the general manager's functions, such as personnel, finance, marketing, raw material supplies, operations, engineering, similar to what the president of a corporation would do.

Q. Can you tell us what South Point Ethanol is?

A. South Point Ethanol is a joint venture partnership that was formed in 1981 to retrofit an existing chemical plant in South Point, Ohio, for the purpose of producing 60,000,000 gallons a year of fuel grade ethanol from food grain.

Q. Where is South Point?

A. At the southernmost tip of the state of Ohio near where Kentucky, West Virginia and Ohio come together on the Ohio River.

(p. 47) Q. You said that South Point is a joint venture. Can you tell us who the participants in that joint venture are?

A. Yes. They are subsidiaries of Ashland Ethanol, Inc., the Ohio Farm Bureau Synfuels Investment Company, Inc., Publicker Gasohol, Inc., and UGI Ethanol Development Corporation.

Q. When did South Point go into production, Sir?

A. We began producing in September of 1982.

Q. I wonder, sir, if you could tell us a little bit about the county and community where South Point is located.

A. It is located in Lawrence County, Ohio, and as I understand the most recent records, Lawrence County has the second highest unemployment rate in the state of Ohio. I think number one is Jackson County just north of Lawrence.

Q. How many people does South Point employ?

A. We have what we call a manning table which is all of the positions created for South Point Ethanol and that's 191 people. We have some vacancies in that table so currently we employ about 185 people directly and we also have outside maintenance contractors in the plant. Their work force varies but it runs 20 to 40 people.

Q. What is the total payroll in terms of dollars?

A. About \$6,000,000 a year.

(p. 48) Q. Can you tell us, sir, briefly the sources for some of the funds that South Point used to retrofit and operate this plant?

A. Okay. Well some of the existing facilities were donated by the partners. The partners also put up cash. They acquired a 24 and a half million dollar loan from the U. S. Department of Energy on a cooperative agreement

and then they had a 32 million dollar group of loans and 90 percent of that 32 million dollars is guaranteed by the Farmer's Home Administration. A portion of that and I believe the number is 23 and a half million dollars is on a note that is held by the public employees retirement system of the state of Ohio.

Q. Can you tell us, sir, what the capacity of production from South Point is?

A. The rated capacity, what we call the designed capacity, is 60,000,000 gallons a year of ethanol.

Q. Are you running at full capacity today?

A. Not quite. We are running in the neighborhood of 90 to 95 percent of capacity.

Q. Let me hand you, sir, what has been marked as defendant's exhibit C and ask you if you tell us what that is.

A. That's the exhibit—

Mr. Young: Your Honor, there is no jury here but (p. 49) it would seem to me that if we have a party here who's damaged by the Ohio legislation and seeking to demonstrate damage to challenge it that whether South Point is operating at a profit or loss and how many people it employs, I fail to see the relevance of that to these proceedings and I object for the record.

The Court: Let me hear what the testimony is and I will determine its relevance later.

Mr. Young: Thank you.

Q. Can you tell us what exhibit C is?

A. Exhibit C is a statistical summary of the economic impact that South Point Ethanol has on the economy of the state of Ohio.

Q. Are those functions reflected on exhibit C, are those an accurate summary of those statistics?

A. Yes.

Q. And the total expenditures down there, they are in fact on an annual basis?

A. Yes, and they depend on the numbers that you see.

Q. Sir, if I understand what's been testified to so far, one of the raw materials in the production of ethanol or in fact the only raw material is corn; is that right?

A. That's right, I would call corn the only real raw material that has changed in the process. We also use a large amount of coal as fuel, it is consumed to give us (p. 50) the energy we need to power our plants.

Q. Can you tell us in 1984 how much corn South Point actually purchased?

A. We purchased about 24,000,000 bushels during 1984.

Q. Can you tell us, sir, where the largest amount of that corn came from in 1984?

A. There were two states that were about equally tied as our largest sources of supply and that was Ohio and Indiana. We bought about 9,000,000 bushels from both of those states.

Q. Can you tell us, sir, where South Point sells its ethanol?

A. Well, we sell throughout, really throughout the Ohio River-Valley network of states. We have a majority of our sales in Ohio and Kentucky but we also have sales in Virginia, a little bit in West Virginia, Tennessee, Indiana, Illinois, Minnesota.

Q. Okay. Indiana?

A. Yes.

Q. Can you tell us where some of the terminals that South Point has are located?

A. We operate through a network of terminals: Vancport, Pennsylvania; South Point, Ohio; Viney Branch, Kentucky; Covington, Kentucky; Cincinnati, Ohio; Clarksville, Indiana; Louisville, Kentucky; Evansville, (p. 51) Indiana; Knoxville, Nashville, Tennessee; those are some examples.

Q. Let me hand you, sir, what has been marked as defendant's exhibit D and ask you to take a moment to look at that and tell me what that is.

A. Periodically our sales department sends notices of our prices at the various terminals out to our customers and this was the letter sent out on March 20th, 1985.

Q. That has a listing of the terminals that South Point sells from?

A. That's right.

Q. And the prices that you would sell your ethanol for at each of those terminals?

A. On that date until they are changed, yes.

Q. Can you tell us the difference between top off and transport, what those mean?

A. Well, the way I speak about them it is two different classes of trade. Top off are very small deliveries. For example, a truck will come into the terminal, or will buy in the terminal a load of gasoline. He will fill up his tanks with 90 percent gasoline and then move to the ethanol portion of the ramp and he will quote top off with 10 percent of ethanol and that's the traditional product that's been called gasohol. It is (p. 52) a mixture of 10 percent ethanol and 90 percent gasoline.

The other way we commonly do business is to sell a full transport truck load full of ethanol.

Q. Can you tell us in 1984 what percentage of your sales of ethanol were in Ohio?

A. In 1984 we sold, I believe the number was 41 percent of our sales of ethanol in the state of Ohio.

Q. Did you have, in 1984, competition in the state of Ohio from other United States based producers of ethanol?

A. Yes.

Q. Can you tell us who those were?

A. Archer Daniels Midland (ADM) and New Energy of Indiana.

Q. Have you made a comparison of your sales in Indiana during 1984 to your present sales this year in Indiana?

A. Yes.

Q. Can you tell us what that comparison showed?

A. It showed on a basis of percentage of our sales moving into Indiana that that percent had dropped about one-third between the year 1984 and so far in 1985.

Q. Can you tell us the reason for the decline of your sales in Indiana?

A. Well, I don't know that I could pinpoint a single (p. 53) reason. I just don't know.

Q. Okay. Does Indiana provide an incentive for the production of ethanol presently?

A. I understand Indiana does.

Q. Has South Point Ethanol ever received any incentive from the state of Indiana for the production of ethanol?

A. No.

Q. Are you familiar with the method used in Ohio and other surrounding states to encourage the use of ethanol in gasoline?

A. Yes. A number of states have offered some mechanism of forgiveness of a portion of their state taxes on the sale of gasoline if the retail seller of that gasoline will blend ethanol into the gasoline.

Q. If present law in Indiana is not changed after July 1 of this year, will there be any incentive to a retail customer or blender in Indiana to use ethanol?

A. No.

Q. Why don't you tell us some of the benefits that result—well, let me ask it this way: you were in the courtroom when Mr. Drenfeld answered some of my questions about the benefits of the use of ethanol; is that correct?

A. Yes, sir.

Q. Do you agree with his views on the public health (p. 54) benefits on the use of ethanol?

A. Yes, I would say so.

Q. Can you explain to us what his present system is for encouraging the use of ethanol?

A. Well, Ohio as the general example I gave before, offered a reduction in the state gasoline tax that otherwise would be due for the retail gasoline dealer to blend ethanol with his gasoline.

Q. How is the reciprocity provision in the Ohio statute, if at all, how does it encourage the use of ethanol?

A. Well, it encourages other state legislatures throughout the country to enact similar legislation to provide a tax credit to that retail gasoline dealer so that he will have an incentive to buy ethanol and blend it with the gasoline that he sells.

Q. Does Ohio's present system for encouraging the use of ethanol, including the reciprocity provision, does that protect South Point Ethanol from competition, from other domestic ethanol producers?

A. No, I don't think it protects South Point Ethanol.

Q. Why not?

A. Because other manufacturers are free to bring their product into the state of Ohio and market it. I don't (p. 55) see where it bars anyone from bringing ethanol into Ohio.

Q. Let's just use an example. You mentioned Archer Daniels Midland, correct? As a competitor?

A. Yes.

Q. Does a reciprocity provision preclude them from receiving the full benefit of Ohio's tax credit?

A. No. I think they are receiving it today.

Q. Now you were also present in the courtroom when Mr. Young asked Mr. Drenfeld some questions about you working in the Ohio legislature with regard to the statute at issue in this case, were you not?

A. Yes.

Q. Did you in fact testify before some committee at the Ohio Legislature with regard to this legislation?

A. Yes, sir.

Q. Do you know what committee it was?

A. I believe it was the Ways and Means Committee of the Ohio House.

Q. Do you remember when you testified?

A. I believe it was in the month of December of '84.

Q. Why don't you tell us just briefly what you told the committee?

Mr. Young: Well, yeah, I would like to hear it.

A. Okay. At that point the bill had been through the Senate and was in the House for consideration.

(p. 56) Q. Did it have the reciprocity provision with it?

A. I believe it did.

Q. What did you tell the committee?

A. In general I reviewed for them the development of ethanol tax incentives in the U. S., federally and at the state level, and encouraged them to pass this bill even though I didn't agree with 100 percent of the bill and in particular, I asked them to begin operation of the bill as soon as possible, to put it into effect as soon as possible. I believe I asked them to do that on January 1, 1985.

Q. Did you tell the committee about the benefits of the use of ethanol?

A. Yes, and as I was saying, I was reviewing the development of industry in this country and saying that the benefits that were brought out just before in the former testimony in this trial were the same benefits that I stressed when I talked to the House Ways and Means Committee saying that now it was the best, most cost effective replacement for lead in gasoline and at that time it was rumored that the EPA would be coming out with a faster lead reduction program, and that the industry needed incentives to use ethanol until such time as it began to be valued for its octane generating qualities.

Q. Did you tell them about the benefits of the (p. 57) South Point plant?

A. Yes, I stressed the development of the South Point project and used a table similar to defendant's exhibit C to stress the economic impact of the South Point plant.

Q. Did you ask that committee or anybody else in the Ohio legislature to protect South Point from competition from ethanol produced by other United States based producers?

A. No, sir.

Q. Did you ask the committee to include the reciprocity provision in the bill?

A. It was in the bill at that time if I remember and I spoke for passage of the bill as it was written at the earliest possible effective date.

Q. Would you tell the court why you did that?

A. In my opinion the strength of the ethanol industry in this country is that if it is marketed broadly throughout all of the states of the union or as many states as possible, and I felt that the bill as constituted helped to do that by providing an incentive, if you will, to other state legislatures to pass similar legislation.

. . .

#### (p. 58) CROSS EXAMINATION

By Mr. Young:

Q. Just a very limited number of questions. You have such a fine Southern accent that I shant try to cross examine you very hard.

A. That from South Point.

Q. When you mentioned the participants in your joint venture at South Point, let's see, Ashland was one of them, farm bureau and was Publicker the name of it?

A. Yes.

Q. Was that Publicker Chemical Corporation?

A. I think the name is Publicker Industries.

Q. Oh, yeah, Publicker Industries. Fine. When you testified before the General Assembly with respect to this reciprocity legislation, did you advise them that one of your principals had been the plaintiff in Florida in the lawsuit that declared reciprocity unconstitutional?

A. No, sir.

Q. You knew that though, didn't you?

A. Yes.

Q. Okay.

A. Can we go back to that question a minute?

Q. Yes. Did you want to—

A. I thought my knowledge of the case in Florida was that it had to do with domestic and I thought that—come (p. 59) to think of it now I thought that Publicker's argument was you could not restrict the sale using the word "domestic" only.

Q. Well, in any event the court has the citation to the case and Mr. Crago, you have seen that case, haven't you?

Mr. Crago: I have seen the case and I'm not sure reciprocity applies to that but I think the case is—

The Court: Mr. Young is just trying to get a little dig in. It has nothing to do with the—

Mr. Young: Your Honor, how could you say something like that?

(Laughter).

Q. At the time you testified before the General Assembly, Ohio already had an ethanol credit program, didn't it?

A. Yes, sir.

Q. What was happening with this new bill is that certain non-Ohio participants were being excluded from it—

Mr. Crago: Objection.

Mr. Young: I will reword it.

Q. In other words the credit, the ethanol credit bill was already in effect and you were lobbying to get it passed with the reciprocity provision in it?

A. Well, there was a law already in effect, yes. (p. 60) several changes were proposed in this new bill that was working its way through the legislature and one of those changes was the addition of the reciprocity clause but there were a number of others.

Q. Basically your support of the reciprocity clause was for the purpose of having Ohio pass legislation that would put pressure on Indiana to pass legislation?

A. Well, my support of the, including the reciprocity clause with all of these changes was as an incentive to all states to enact all legislation that would promote the sale of ethanol in their states.

. . .

(p. 61) The Court: When you rebuilt South Point, did you get tax incentives from the state?

The Witness: Your Honor, I was not involved in the project at that time because that was in 1981 that that

construction was going on, but to my knowledge the answer to that question is yes.

The Court: And you are still getting it?

The Witness: I don't think we are getting (p. 62) anything from the State of Ohio today.

The Court: Did they just give you one year?

The Witness: We pay property tax, if that's your question. The only thing we did get was on some equipment that went into the plant and I know in particular for the waste water treatment, you know, pollution control equipment, we did get forgiveness of I believe the sales tax on the purchase—

Mr. Farrin: Your Honor, could I speak to this? I think there may be some confusion in his response to your question with respect to tax exemptions which I can clear up because I represent the Tax Commissioner and understand specifically what he is speaking of, if you don't mind me—

The Court: I don't mind but my point is—

Mr. Farrin: There is a pollution control exemption for any manufacturing in Ohio for pollution control equipment and I believe that's the incentive he is talking about.

The Court: But my point is South Point is getting their stuff and New Energy is getting their stuff from Indiana.

Mr. Farrin: This is for all manufacturing and not specifically for ethanol plants.

The Witness: We had no special incentive of any (p. 63) kind for our plants that any other industry could not have gotten and that's my understanding coming in after the fact.

• • •

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## PLAINTIFF'S EXHIBIT 3

STATE OF OHIO  
DEPARTMENT OF TAXATION  
State Office Tower  
P. O. Box 530  
Columbus, Ohio 43216

January 28, 1985

Barry Direnfeld  
New Energy Corporation  
Suite 200  
915 15th Street N.W.  
Washington, D.C. 20005

Dear Mr. Direnfeld:

We are writing in reference to our telephone conversation concerning Ohio's ethanol credit.

Am. Sub. Senate Bill 334 was passed effective January 1, 1985. This bill defines qualified fuel as "Ethanol that is to be combined with gasoline to create a blend of not more than ten percent by volume of ethanol and that when so blended is used, sold or distributed as a motor vehicle fuel." (Methanol produced from coal is no longer a qualified fuel.) Ethanol is defined as "Ethanol produced through a coal-fired process from wood or the grain of a cereal grass and denatured in accordance with the United States bureau of alcohol and tax regulations." Ethanol produced in a manufacturing facility with an annual production capacity of less than 2,000,000 gallons and otherwise qualified for the credit does not have to be produced through a coal-fired process.

The bill also contains a reciprocity provision. Fuel containing ethanol produced outside Ohio will qualify for

the credit *only if* the ethanol was produced in a state that grants a credit for similar fuel containing ethanol produced in Ohio. (Such credit may be a motor vehicle fuel tax or sales tax exemption or refund.)

The bill further provides that a licensed Ohio motor vehicle fuel dealer may claim credit on alcohol that does not meet the new definition when such alcohol was purchased or acquired or held in inventory before January 1, 1985. The reciprocity requirement does not apply to such fuel. Enclosed is a copy of emergency rule 5703-11-04 which describes this in more detail.

Another change pertains to the amount of qualified fuel credit. As the federal government's credit increases, Ohio's credit will decrease and as the federal credit decreases, Ohio's credit will increase. Ohio's maximum credit is 35¢ per gallon. On February 1, 1985, the Tax Commissioner will compute Ohio's credit. As it now stands, Ohio's qualified fuel credit will be 35¢ per gallon for January. On February 1, 1985, it will drop to 25¢ per gallon and will remain there until the federal credit changes again.

We have checked with the Indiana Department of Revenue and have determined that the credit given in Indiana is the equivalent to 25¢ per gallon of ethanol. Based on this, ethanol produced by New Energy Corporation in Indiana and purchased on or after January 1, 1985, will only receive a 25¢ per gallon credit during January. Ethanol which falls under rule 5703-11-04, however, is not subject to the reciprocity provision and would receive a 35¢ per gallon credit during January.

Effective February 1, 1985, Ohio's credit will decrease to 25¢ per gallon. Unless Indiana's credit decreases (it is based on the retail price of gasoline), ethanol produced in Indiana will receive the same credit as other ethanol. We have been informed that the Indiana credit ends June 30, 1985. Therefore, Indiana produced ethanol will not qualify for credit in Ohio beginning July 1, 1985, unless it qualified under rule 5703-11-04.

If there are any further questions, please contact the undersigned.

Cordially,

/s/

Richard O. Beckner  
Administrator  
Excise, Motor Fuel and  
Highway Use Tax Division  
Phone: (614) 466-3794

ROB/ml

Encs: (as stated)

PLAINTIFF'S EXHIBIT 4

STATE OF OHIO  
DEPARTMENT OF TAXATION  
State Office Tower  
P. O. Box 530  
Columbus, Ohio 43216

February 7, 1985

Bob Reynolds  
New Energy Company of Indiana  
P.O. Box 2289  
South Bend, Indiana 46680-2289

Dear Mr. Reynolds:

We are writing in reference to our conversation on February 5, 1985, concerning the Ohio motor vehicle fuel tax credit given for qualifying ethanol produced in Indiana.

The credit for February, 1985 will be 25¢ per gallon. Because of the reciprocity section in Am. Sub. H.B. 334, this may change as Indiana's credit changes on ethanol produced in Ohio. Since Indiana's credit is scheduled to only go through June 30, 1985, ethanol produced in Indiana but blended after June 30, 1985, will not receive the credit. This pertains to ethanol whether it was produced before or after June 30, 1985. The only exception would be ethanol that qualifies under rule 5703-11-04.

The Indiana credit is through a reduction in the state sales tax on gasoline sold at retail and dispensed through a metered pump. Gasoline, without ethanol, is subject to a 5% state sales tax. Gasoline blended with ethanol (gasohol) is only subject to a 2.5% state sales tax. This credit will be computed each month and Ohio licensed motor vehicle fuel dealers will be advised of any changes.

If we can be of any further assistance, please advise.

Cordially,

/s/

Richard O. Beekner  
Administrator  
Excise, Motor Fuel and  
Highway Use Tax Division  
Phone: (614) 466-3794

ROB/ml

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# PLAINTIFF'S EXHIBIT 5

**THE COST OF ETHANOL PRODUCTION**  
is approximately \$1.32/GALLON  
excluding cost of debt retirement and  
depreciation.

Invoice Price of  
Ethanol Per Gallon

- .73 Net average price for gallon of regular gasoline.  
Ohio credit per gallon of ethanol.
- +.60 Federal credit per gallon of ethanol.
- 1.58 (Since the credit is collected by the retail  
distributor, he would, after the credits, have  
the same price as non-ethanol blend.)
- .20 Discount—incentive to induce customer  
to use ethanol.
- 1.38 Delivered gross price of gallon of pure ethanol  
paid by customer.
- .06 Average transportation cost from  
South Bend to Ohio.
- \$1.32 New Energy's net FOB plant price per gallon  
of ethanol.

## CONCLUSION

This provides New Energy with only enough  
revenue to cover interest payments, but not  
principal or depreciation. There is no way it  
could reduce ethanol prices further.

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## PLAINTIFF'S EXHIBIT 6

## Incentive For Customer

1.38	Delivered price for gallon of ethanol.
— .25	Ohio credit per gallon of ethanol.
— .60	Federal credit per gallon of ethanol.
<hr/>	
\$ .53	Net cost per gallon of ethanol after credits.
NOTE: This is \$.20 per gallon less than price of gallon of regular gasoline.	

GASOLINE/ETHANOL  
BLEND ECONOMICS

All gasoline/ethanol blends consist of 90% gasoline and 10% ethanol. This table illustrates the value of blends to the retailer.

## 90/10 BLEND COST

53¢	Net ethanol price per gallon to customer	$\times 10\% = 5.3¢$
73¢	Net price per gallon for regular gasoline	$\times 90\% = 65.7¢$
<hr/>		

Net total price to customer for gallon of gasoline/ethanol blend. 71 ¢

Customer who purchases and blends ethanol will increase his margin by 2¢ per every gallon blend he sells compared to regular gasoline.

---

## PLAINTIFF'S EXHIBIT 7

PRICE OF ETHANOL  
WITHOUT OHIO CREDIT

\$1.38	Delivered price for gallon of ethanol
— 0	No Ohio credit.
— .60	Federal credit per gallon of ethanol.
\$ .78	Net cost per gallon of ethanol.
<hr/>	

## 90/10 BLEND COST

78¢	Net ethanol price per gallon to customer	$\times 10\% = 7.8¢$
73¢	Net price per gallon for regular gasoline	$\times 90\% = 65.7¢$
<hr/>		
Net total price to customer for gallon of gasoline/ethanol blend.		73.5¢
<hr/>		

## DEFENDANT'S EXHIBIT C

SOUTH POINT ETHANOL  
STATISTICS

Production: 60MM Gallons Per Year of Ethanol  
220MM Tons Per Year of Distillers  
Dried Grains with Solubles (DDGS)

Investment: \$120MM +

	<u>\$MM</u>
Number of Employees: 191—Annual Salary of \$5.5 to \$6.0MM	6.0
Contract Maintenance Employees: 40-60 on Continuous Basis Estimated Annual Salary	2.1
Personal Property and Other State and Local Taxes	1.3
Feedstock Cost—Corn —24.0 Million Bushels Annually at 2.95/Bushel	70.8
Coal—180,000 Tons Per Year at \$30.00/Ton	5.4
Power—Annual Usage will be in excess of:	2.5
Other Services—Chemicals, Enzymes, Yeast, Maintenance, Materials and Equipment, Denaturants	11.6
Total Annual Expenditures	99.7

## IN THE SUPREME COURT OF OHIO

NEW ENERGY COMPANY	)	
OF INDIANA,	)	Case No. 86-784
	)	
Appellant,	)	An Appeal from
	)	the Tenth District
v.	)	Court of Appeals,
	)	Franklin County
JOANNE LIMBACH,	)	Case No.
TAX COMMISSIONER, et al.,	)	85AP-340
	)	
Appellees.	)	

AFFIDAVIT IN SUPPORT OF MOTION  
FOR EXPEDITED ARGUMENT

District of Columbia :  
: SS  
:

Donald Evans, being first duly sworn, deposes and states:

1. I am the Chief Operational Officer for New Energy Company of Indiana and positively state the following with respect to the appeal pending before the Supreme Court of Ohio.

2. Since July 1, 1985, New Energy has been prevented by the Ohio Reciprocal Tax Credit Amendment from selling any of the ethanol produced by it in the State of Ohio. The enactment of this Ohio legislation also forced it to cancel a supply contract with an Ohio customer for approximately 15% of New Energy's annual output.

3. This appeal was argued on an expedited basis before the Franklin Court of Appeals in June, 1985. New

Energy anticipated a decision within a reasonable time after arguments. The eleven-month delay between argument and decision placed New Energy in a very serious financial condition.

4. In order to market the volume of product previously sold in Ohio, New Energy has had to lease approximately thirty-four rail cars and incur substantial transportation costs to sell ethanol in places as remote as North Dakota, Utah and North Carolina. Marketing product in distant markets also negatively impacts cash-flow and increases the cost of money by substantially lengthening payment and delivery cycles.

5. New Energy's \$185,000,000 facility was designed on the assumption of maintaining a large percentage of sales by truck into the nearby Ohio market. New Energy had no way of knowing that Ohio would subsequently enact the Reciprocal Ethanol Tax Credit amendment which had the practical effect of barring Indiana-produced ethanol from the Ohio market.

6. Effective July 1, 1986, the Indiana sales tax exemption for *all* ethanol/gasoline blends was eliminated. Therefore, after July 1, 1986, New Energy's ethanol does not qualify for any credit in Ohio.

7. Effective June 1, 1986, the Illinois General Assembly reduced its ethanol tax exemption. This, in turn, prevents Illinois producers from competing with an Ohio producer on an equal competitive footing. The major competitor left, after New Energy was barred by the Ohio legislation, is ADM, and it will not receive the full Ohio exemption.

8. The Indiana legislature previously decided not to appropriate any funds for the fiscal year commencing July 1, 1986 for a grant program for New Energy. Thus, New Energy no longer receives any such grant funds.

9. For the foregoing reasons and because of the inordinate delay at the Franklin County Court of Appeals level, it is critical that New Energy receive the decision of this Court at the earliest possible date.

Further Affiant saith naught.

/s/ Donald Evans

Sworn to and subscribed before me on this 13th day of August, 1986.

/s/ Carolyn L. Cook  
Notary Public

EXHIBIT 1

—  
(SEAL)

STATE OF OHIO  
DEPARTMENT OF TAXATION  
STATE OFFICE TOWER  
P. O. BOX 530  
COLUMBUS, OHIO 43216  
May 12, 1986

INFORMATIONAL RELEASE  
TO: ALL LICENSED MOTOR VEHICLE FUEL  
DEALERS  
RE: QUALIFIED FUEL CREDIT

Due to a reduction in the *Illinois* ethanol credit, all qualifying ethanol produced in *Illinois* and blended from June

1, 1986 through June 30, 1986, will receive a credit of \$.20 per gallon. Also, the credit for qualifying ethanol produced in *Indiana* will receive a credit of \$.09 per gallon when blended from June 1, 1986 through June 30, 1986. We wish to remind you it is your responsibility to obtain a statement from the supplier of the ethanol as to the qualifications of the ethanol. Before claiming the qualified fuel credit on your monthly tax return, you must first determine where the ethanol was produced. Credits taken must be at the appropriate rate. The credit for qualifying ethanol produced in Ohio remains at \$.25 per gallon.

You will be notified of further changes on a calendar quarter basis. Our next notification will be mailed in early June and will cover qualifying ethanol blended from *July 1, 1986 through September 30, 1986*. Please Contact us if you have any questions.

Ohio Department of Taxation  
Motor Fuel Tax Compliance Unit  
P.O. Box 530  
Columbus, Ohio 43216  
Telephone: (614) 466-3503

## EXHIBIT 2

(SEAL)

STATE OF OHIO  
DEPARTMENT OF TAXATION  
STATE OFFICE TOWER  
P. O. BOX 530  
COLUMBUS, OHIO 43216

June 10, 1986

## INFORMATIONAL RELEASE

TO: ALL LICENSED MOTOR VEHICLE FUEL DEALERS

RE: QUALIFIED FUEL CREDIT

As stated in our informational release of May 12, 1986, changes in the qualifying ethanol credit would be reported on a calendar quarter basis. Therefore, credit for qualifying ethanol produced in *Illinois* and blended from *July 1, 1986 through September 30, 1986* will be \$.17 per gallon. Due to *Indiana's* elimination of their ethanol credit, Ohio will *not* give credit for ethanol produced in *Indiana* and blended on or after *July 1, 1986*.

We wish to remind you it is your responsibility to obtain a statement from the supplier of the ethanol as to the qualifications of the ethanol. Before claiming the qualified fuel credit on your monthly tax return, you must first determine where the ethanol was produced. Credits taken must be at the appropriate rate. The credit for qualifying ethanol produced in *Ohio* remains at \$.25 per gallon.

Our next notification will be mailed in September, 1986 and will cover qualifying ethanol blended from October 1,

1986 through December 31, 1986. Please contact us if you have any questions.

Ohio Department of Taxation  
Motor Fuel Tax Compliance Unit  
P.O. Box 530  
Columbus, Ohio 43216  
Phone: (614) 466-3503

EXHIBIT 3

---

IN THE SUPREME COURT OF OHIO

NEW ENERGY COMPANY	)	
OF INDIANA,	)	
	)	
	)	Appellant,
	)	
v.	)	Case No. 86-784
	)	
JOANNE LIMBACH,	)	
TAX COMMISSIONER, et al.,	)	
	)	
	)	Appellees.

AFFIDAVIT IN SUPPORT OF MOTION FOR  
SUPERSEDEAS AND TEMPORARY  
INJUNCTIVE RELIEF

STATE OF INDIANA    )  
                              ) SS:  
COUNTY OF MARION    )

Donald Evans, being first duly sworn deposes and states:

1. I am the Chief Operational Officer for New Energy Company of Indiana and positively state the following with respect to the appeal pending before the Supreme Court of Ohio.

2. This Affidavit supplements information supplied in my Affidavit in Support of Motion for Expedited Argument, filed before this Court on August 15, 1986.

3. The ethanol dealer credit program in Ohio which grants full credits to customers of the Ohio producer, but none to customers of New Energy continues to cause irreparable damage to New Energy's business.

4. Whereas we formerly supplied over one million gallons of ethanol per month to Ohio customers, our December 1986 shipments were approximately 40,000 gallons. This shipment was to a single unique customer who does not solicit competitive bids. Our Ohio business has, as a result of the amended Ohio ethanol credit program, fallen from approximately 20% of our total output to less than 1% of our total output.

5. After the notice of the Supreme Court of Ohio decision that the ethanol credit law was unconstitutional, New Energy immediately received revived interest from potential Ohio customers. After the notice of rehearing became public, that interest again dissipated. Notification of the actions taken by the Supreme Court received industry-wide publicity in *Alcohol Update*. Copies of the pertinent page of that publication reflecting notices of this Court's action are attached as Exhibit A.

Further Affiant saith naught.

/s/ Donald Evans

Sworn and subscribed before me on this 4th day of February, 1987.

/s/ Nancy L. Johns  
Notary Public  
Resident: Shelby Co.  
Commission Expires: 7/18/90

---

No. 87-654

JAN 15 1988

JOSEPH F. SPANIOLO, JR.  
CLERK

# In the Supreme Court of the United States

October Term, 1987

NEW ENERGY COMPANY OF INDIANA,

*Appellant,*

v.

JOANNE LIMBACH,  
TAX COMMISSIONER OF OHIO, MARY ELLEN WITHROW,  
TREASURER OF OHIO, and SOUTH POINT ETHANOL,

*Appellees.*

On Appeal from the Supreme Court of Ohio

## APPELLANT'S BRIEF

HERMAN SCHWARTZ\*  
207 Myers Hall  
4400 Massachusetts Ave., N.W.  
Washington, D.C. 20016  
202/885-2648

DAVID J. YOUNG  
MURPHEY, YOUNG AND SMITH  
250 E. Broad Street  
Columbus, Ohio 43215  
614/228-4371

*Attorneys for Appellant  
New Energy Company  
of Indiana*

\*Counsel of Record

## QUESTIONS PRESENTED

Prior to 1985, Ohio granted a credit to the motor vehicle fuel tax for gasohol, which is a 90-10 blend of gasoline and ethanol. Ohio R.C. 5735.145 (1981). On December 20, 1984, Ohio amended the statute by denying the credit to gasohol containing ethanol produced in another state, unless the producer state grants a credit to gasohol sold there containing Ohio-produced ethanol. Ohio R.C. 5735.145(B). The credit that Ohio grants out-of-state ethanol is limited to the amount of credit granted Ohio ethanol in the other state.

The following questions are presented by this appeal:

1. Does the Commerce Clause allow Ohio to insist on such forced reciprocity even if, as the trial court found, its practical effect is to bar and/or remove from the Ohio market ethanol produced in those states that choose not to give such a credit?

2. Is a forced reciprocity provision enacted for the purpose of promoting domestic industry and to induce other states to grant reciprocal tax credits consistent with the Commerce Clause?

3. Is the forced reciprocity provision constitutional because at least some of the ethanol produced outside Ohio is eligible for the tax credit and can enter the Ohio market, even though because of that provision, ethanol produced in many other states cannot?

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P.L. 97-358 (1982)	5
P.L. 98-369 (1984)	5
P.L. 100-17 (1987)	5
40 CFR Part 80 (1985)	7

## OTHER

Indiana § 4-4-10.1-1 (1984)	10, 11
Ohio R.C.5735.145 (1981)	24
Ohio H.B.419 (1987)	12

## OTHER AUTHORITIES AND SOURCES

Alcohol Update (misc. issues)	7, 8, 20, 21
U.S. Motor Fuel Legislative and Regulatory Service	8, 21
Note, <i>The Supreme Court 1977 Term</i> , 92 Harv. L. Rev. 1, 66 (1978)	37
Regan, <i>The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause</i> , 84 Mich. L. Rev. 1091 (1986)	18
Siegel, Carr, Gelb, & Mielke, <i>Analysis of Possible Effects of H.R. 2052, Legislation Mandating the Use of Ethanol in Gasoline</i> , Cong'l Research Service Report for Congress 87-819 SPR (Oct. 13, 1987)	5
Smith, <i>State Discriminations Against Interstate Commerce</i> , 74 Calif. L. Rev. 1203, 1246 (1986)	18
Vaughn, Testimony before House Subcommittee on Energy and Power, June 24, 1987	8

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In the Supreme Court of the United States

October Term, 1987

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NEW ENERGY COMPANY OF INDIANA,  
*Appellant,*

v.

JOANNE LIMBACH,  
TAX COMMISSIONER OF OHIO,  
AND SOUTH POINT ETHANOL,  
*Appellees.*

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**APPELLANT'S BRIEF**

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Appellant New Energy Co. appeals from a final order of the Supreme Court of Ohio, on rehearing, rejecting a challenge to Ohio Revised Code 5735.145(B), an amendment to the Ohio motor fuel tax that was enacted December 20, 1984 and became effective January 1, 1985. The amendment conditioned the grant and amount of a credit to such tax for gasohol containing ethanol produced in a state

other than Ohio, on the availability and amount of a credit for Ohio-produced ethanol in such other state. The Supreme Court of Ohio held that the statute did not violate Article I, sec. 8, cl. 3, the Commerce Clause, of the United States Constitution.

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### OPINIONS BELOW

The opinion of the Ohio Supreme Court on rehearing is reported at 32 Ohio St. 3d 206, and is reprinted at the Appendix to the Jurisdictional Statement at J. St. App. 1a.<sup>1</sup> The original decision of the Ohio Supreme Court has not been reported and is reprinted at J. St. App. 20a. The opinion of the Tenth Appellate District of the Court of Appeals of Ohio is not officially reported and is reprinted at J. St. App. 35a. The opinion and decision of the Court of Common Pleas of Franklin County, Ohio is not officially reported and is reprinted at J. St. App. 56a.

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### JURISDICTION

The Ohio Supreme Court rendered its opinion and entered a final judgment on rehearing on September 2, 1987. A Notice of Appeal to this Court was timely filed with the Ohio Supreme Court on October 9, 1987, and the

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<sup>1</sup>References to the Appendix to this brief are "App. —"; to the Joint Appendix "JA —"; and to the Appendix to the Jurisdictional Statement "J. St. App."

appeal docketed within 90 days of the rendering of the Ohio Supreme Court's decision and judgment on rehearing. A jurisdictional statement was filed on October 22, 1987 and probable jurisdiction noted on December 14, 1987. The jurisdiction of this Court is invoked under 28 U.S.C. sec. 1257(b).

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### CONSTITUTIONAL PROVISION AND RELEVANT STATUTES

Article I, sec. 8, cl. 3 of the United States Constitution provides that:

1. The Congress shall have power . . . to regulate commerce with foreign nations, and among the several States, and with the Indian tribes.

Ohio Revised Code 5735.145(B) (1984) provides that:

(B) The qualified fuel otherwise eligible for the qualified fuel credit shall not contain ethanol produced outside Ohio unless the tax commissioner determines that the fuel claimed to be eligible for credit contains ethanol produced in a state that also grants an exemption, credit or refund from such state's motor vehicle fuel excise tax or sales tax for similar fuel containing ethanol produced in Ohio; provided however, that such credit shall not exceed the amount of the credit allowable for qualified fuel containing ethanol produced in Ohio.

The full text of R.C. 5735.145, as amended in 1984, is in the Appendix to this brief.

## STATEMENT OF THE CASE

This is an appeal from a decision by a 4-3 majority of the Supreme Court of Ohio, on rehearing, upholding an Ohio tax statute, Ohio Rev. Code § 5735.145(B) against a challenge under the Commerce Clause of the United States Constitution, Article I, § 8, cl. 3. The decision overturned a prior decision of the Ohio Supreme Court that had struck down the statute by a 4-3 majority. The case involves state tax incentives for the use of ethanol in gasoline and the denial of the Ohio tax credit for ethanol produced in other states, unless the latter provide Ohio-produced ethanol sold there with a credit.

### The Product

Ethanol is an ethyl alcohol, almost 200 proof, derived primarily from corn; a bushel of corn yields approximately 2½ gallons of ethanol. The corn is treated with enzymes that convert the starch into sugar and ultimately into alcohol. Ethanol is also obtainable from sugar cane, sugar beets, wheat, molasses and virtually any raw material containing carbohydrates. It can serve as an automotive fuel, and has gained increasing use as an octane enhancer in place of lead, in a 90:10 gasoline to ethanol ratio. The blend is commonly known as "gasohol".

### The Industry and the Market

Although alcohol fuels were marketed as early as the 1920's, the uses of ethanol as a motor fuel first became a serious possibility in the mid-1970s, as a result of the energy crisis. Ethanol, however, is generally more expensive than gasoline, and the federal government therefore created a variety of economic incentives to its use. First, Congress enacted P.L. 95-617, the Energy Tax Act of 1978,

which exempts fuels containing 10% or more of alcohol produced from renewable resources from 4¢ per gallon of the federal excise tax on gasoline. According to the Congressional Research Service, "This legislation made the use of 'gasohol' economically competitive; [and] the blend began appearing on the market in 1979." Siegel, Carr, Gelb & Melke, *Analysis of Possible Effects of H.R. 2052, Legislation Mandating the Use of Ethanol in Gasoline*, Cong'l Research Service Report for Congress 87-819 SPR, p.6. (Oct. 13, 1987). ("CRS Study")

The federal government followed the excise tax exemption with tax credits for blenders and other uses of alcohol, P.L. 96-223 (1980); loan guarantees, price guarantees, purchase agreements, and research, P.L. 96-294, (1980); a tariff on imported fuel ethanol (Brazil was of particular concern), P.L. 96-499 (1980); encouragement of the use of surplus stocks, P.L. 97-358 (1982); and increases in the excise tax exemption to 6¢ out of 9¢, P.L. 98-369 (1984). In 1987, the excise tax exemption was extended to 1993. P.L. 100-17.

Many states, particularly in the heavy grain-producing areas in the Midwest, also provided incentives of various kinds. Thirty-two states ultimately provided some form of sales tax reduction and eight states provided producer incentives. The states that provided incentives and the amounts, in January 1985 and in October 1987, are set out in maps appended to this brief. App. 1a, 2a. Some nine states require reciprocity in addition to Ohio, but of those, four states do not enforce it because of an Attorney General Opinion or court ruling that reciprocity is unconstitutional. (Tennessee, Idaho, Alabama and Illinois).

The pricing of gasohol and its relation to the federal and state sales tax exemptions are illustrated in Plaintiff's Exs. 5 and 6, JA 147-48. As explained at the hearing, if, for example, ethanol costs \$1.32 per gallon, and the dealer or jobber must be paid approximately 20¢ per gallon of ethanol to compensate him for blending, then 10% of the ethanol gallon costs 15.2¢ (13.2+2). If, as was true in 1984-85, the wholesale price of gasoline is approximately 73¢ a gallon, then 10% of a gallon of ethanol is approximately 7.9¢ more than the 10% gasoline that it displaces in a gallon of gasohol. (15.2 against 7.3) The 6¢ federal tax credit covers most of this, and the state tax credit may cover the rest, although freight costs—approximately 6¢ per gallon of ethanol, or .6¢ per 10%—consume some of this. Plaintiff's Exs. 5-7 explain this with respect to Ohio in 1985.<sup>2</sup>

In addition to providing a potentially huge new market for corn, see CRS Study 11, 71 (potentially 1.7 billion bushels per year by 1992) ethanol also is environmentally benign, decreasing carbon monoxide emissions. This is a special problem for Western States. Some questions have recently been raised, however, about its effect on ozone in certain areas. See generally CRS Study 46, 67-80.

<sup>2</sup>The retail price of a gallon of 100% gasoline was \$1.58, or 15.8¢ per 10%. The price of 10% of a gallon of ethanol, after allowing for the federal and Ohio credits, is 13.8¢. The 2¢ per gallon difference is necessary to induce a dealer to use ethanol. Without the Ohio credit, the equivalent wholesale price of gasohol is a half cent more than gasoline. At this price, ethanol is unattractive to the dealer, since differences of a cent or more per gallon are significant because of volume. JA 76-77

The cost of producing ethanol, as set out in the exhibit, factors in revenues from by-products from the production of ethanol.

In 1985, the ethanol industry received an additional boost when the Environmental Protection Agency ordered the gradual elimination of lead from gasoline. 40 CFR Part 80. Lead is an octane enhancer, and its removal requires the substitution of other enhancers, which can be either oxygenates such as ethanol, methyl tertiary butyl ether, methanol and tertiary butyl alcohol, or aromatics like toluene, benzene and xylene. Octane can be enhanced also by increasing refining severity through processing gasoline feed stocks at higher temperatures. Some of these products and processes can be produced or done by the oil companies themselves.

Until the lead reduction requirements and the need for alternate octane enhancers, the oil companies generally opposed the use of ethanol, since it replaced some of the oil companies' gasoline with a grain product produced by others; many still do. Many oil companies therefore opposed the grant of ethanol incentives. See JA 69, 91-92, 102. See, e.g., *Alcohol Update*, Jan. 26, 1987, p.1 (Congressmen protest to Federal Trade Commission about anti-ethanol ads by major oil companies); Feb. 23, 1987, p.3 (Louisiana anti-ethanol campaign); Jan. 19, 1987, p.1 (American Petroleum Institute Committee formerly opposed, but will study further.) See also *Amicus Curiae Brief for Marathon Petroleum Company Urging Reversal in New Energy Co. v. Limbach*, Sup. Ct. Ohio, p.1.

Despite these and other problems—e.g. consumer acceptance, freight costs (JA 63) — the ethanol market has continued to grow, stimulated especially by farmers' economic problems. Ethanol fuel consumption has grown from 0 in 1978 to some 750-800 million gallons/year in 1986-87 with ethanol blends accounting for approximately

8% of United States gasoline consumption. New plants are being built throughout the nation, see *Alcohol Update* Dec. 14, 1987, p.1.; Nov. 30, 1987, p.1.; Nov. 23, 1987, p.1, even though many states have been phasing out or reducing their tax credit. See, e.g., Michigan, Colorado, Illinois, Indiana, Florida. Ohio plans to do likewise. Indeed, ethanol use has grown even in states without the state tax credit. Colorado has mandated its use, Information Resources, Inc., *U.S. Motor Fuel Legislative and Regulatory Service-Colorado* (1987) and other states are considering similar measures, in whole or in part. See *Alcohol Update*, March 9, 1987 (Minn.), July 20, 1987 (Iowa). As of October, 1987 "the leading states in blend sales were Illinois, Ohio, Kentucky, Indiana and Iowa, in that order; leading states in terms of market share were Kentucky, Iowa, Nebraska, Illinois and Indiana in that order." CRS Study 4. According to an industry spokesman, ethanol accounted for 38.7% of the motor fuels used in Kentucky, 27.8% in Iowa, 27.4% in Nebraska, 27.2% in Illinois and 22% in Indiana. Testimony of Eric Vaughn before the House Committee on Energy and Commerce, Subcommittee on Energy and Power, June 24, 1987, p. 2(mimeo).

### Industry Members

The largest factor in the industry is Archer, Daniels & Midland, which has plants throughout the country and accounted for approximately 50% of ethanol production in 1986. It has plants in Illinois and Iowa, and it sells in Ohio. Pekin Energy Company, owned largely by Texaco and the Corn Products Company with a plant in Illinois, and A.E. Staley, with a plant in Tennessee, but headquartered in Illinois, also produce ethanol, and sell in the Ohio market. JA 77, 122, 126

South Point Ethanol was formed in 1981 to retrofit an existing chemical plant in South Point, Ohio. It is a joint venture among Ashland Ethanol, Inc., the Ohio Farm Bureau, Synfuels Investment Company, Publicker Gasohol, Inc. and UGI Ethanol Development Corp. JA 127-29 It is also the beneficiary of a \$23.5 million loan from the Ohio Public Employees Retirement Fund, and has received tax credits for anti-pollution equipment. JA 140

The South Point plant is located in a county with the "second highest rate of unemployment in the state of Ohio"; the highest unemployment rate is in an adjacent county to the north. It employs 191 people, and has 20-40 outside maintenance contractors. Its annual payroll is about \$6 million. JA 128 In 1984, it purchased 24,000,000 bushels of corn, largely from Ohio and Indiana, and approximately 180,000 tons of coal. Its 1984 budget was \$99.7 million. JA 130 See Def. Ex. C., JA 150.

In March 1985, South Point had a capacity of some 60 million gallons annually and sold primarily in Ohio (41%) and Kentucky, with lesser amounts in Virginia, West Virginia, Tennessee, Indiana, Illinois and Minnesota. In 1984, all these states but Indiana and West Virginia had substantial tax credits. See map in App. 1a. West Virginia, however, produced no ethanol and used almost none.

New Energy Company is the newest of these four producers. It was formed in 1980, and capitalized in 1982 at \$185 million, primarily through a \$140 million bank loan, 90% of which was guaranteed by the Department of Energy ("DOE") pursuant to the Energy Security Act of

1980. (In 1986, New Energy was forced to default on that loan, and DOE assumed and restructured it; the loan now totals approximately \$107 million and is being repaid directly to the United States Treasury) DOE also provided a direct loan, as did the City of South Bend from an Urban Development Action Grant. JA 56-57

Construction of the New Energy plant started in 1982, and it started to produce ethanol in October 1984 with a projected annual capacity of approximately 4.7 million gallons of ethanol per month, and a projected annual capacity of approximately 60 million gallons. By March 1985, it was operating at approximately 75-80% of capacity. JA 56 For freight and tax credit reasons, its primary markets were projected to be Indiana, Illinois and Ohio. In Ohio, it projected ethanol sales of 1.7 million gallons per month, or approximately 20-21 million gallons annually. In March 1985, approximately 20-25% of its sales were in Ohio. JA 63-64

After passage of the reciprocity amendment, New Energy's sales in Ohio fell to virtually nothing and it was forced to incur much higher freight costs in order to sell its product elsewhere. See JA 152, (Affidavit of Donald Evans). Loss of the Ohio credit has excluded New Energy from competing for business in the Ohio market since passage of the amendment, in December 1984, and has caused it serious injury. JA 157-58; J. St. App. 58a, 63a.

### **The Legislation**

In 1984, Indiana adopted legislation establishing a fund, subject to annual appropriation, providing production grants to entities that establish an ethanol plant in a blighted area employing 75 or more employees. Indiana

Code 4-4-10.1-1 (1984 Supp.) The grant is on a per gallon basis, with the amount of the grant to be set each year, up to a maximum; in the first year, the grant was only 10¢ per gallon, though the statutorily permissible amount was 25¢. No money has been appropriated since July 1, 1986, and no grants have been made since then.

As of 1977, Indiana also had a sales tax credit, computed as a percentage of the retail selling price. JA 67-68 In 1984 and January 1985, the credit came to approximately 25¢ per gallon of ethanol. Oil companies, as noted, had consistently opposed incentives for ethanol, as the trial court recognized, JA 102, and despite New Energy's desires to the contrary, see JA 103, succeeded in getting the Indiana sales tax credit repealed, as of July 1, 1985. JA 69

Ohio had also had a sales tax credit, first adopted in 1981, when South Point Ethanol was established. R.C. 5735.145. It was available for all gasohol sales, without distinction as to where the ethanol was manufactured; New Energy had obviously relied on this in planning its marketing. In 1984, the credit was 35% per gallon of ethanol but when the federal exemption was raised that year by 1¢, the Ohio credit was lowered proportionately to 25¢ per gallon, effective February 1985.

But by February 1985, this credit was made conditional on the tax credits available in the place of origin. After the Indiana sales tax repeal statute was adopted, Ohio S.B. 334 was introduced limiting the Ohio tax credit to ethanol produced in states that gave Ohio-produced ethanol a credit for Ohio ethanol sold in those states; moreover, the credit for foreign ethanol sold in Ohio was limited

to the amount of credit the foreign state gave Ohio ethanol, so that if Ohio gives 3.5¢ to Ohio ethanol but Illinois gives only a 1¢ credit, Illinois ethanol gets only 1¢ credit in Ohio. South Point lobbied "heavily for it [the reciprocity amendment] so they would put pressures on Indiana and perhaps [New Energy's President] for some number in Indiana for them at the pump." JA 123 This testimony, (which was never challenged), was reinforced by the testimony of South Point General Manager Lauren Hill. JA 139, 136

As part of his lobbying, Mr. Hill told the Ohio legislature of "the benefits of the South Point Plant," and he "stressed the development of the South Point project and used a table similar to Defendant's Exhibit C. to stress the economic impact of the South Point plant." JA 136

The lobbying was obviously successful, and the tax credit statute was amended to deny some or all of the Ohio tax credit to ethanol produced in any state that did not provide the same level of tax credit for Ohio ethanol as Ohio did. Rev. Code 5735.145(B).

The Ohio credit statute has been amended again. Legislation passed in the 1987 session of the legislature reduced the credit to 20¢ in July 1, 1988, 15¢ on July 1, 1990 and 0 on July 1, 1993. H.B. 419, 1987 Leg. Sess.

### **The Litigation and Proceedings to Date**

Recognizing that the Ohio reciprocity amendment would effectively exclude it from the Ohio market, New Energy sued the State defendants in the Common Pleas Court of Franklin County, and sought a preliminary injunction. A hearing was held on March 1, 1985. South Point Ethanol, asserting it was a necessary party, see

*Brief for Appellee South Point Ethanol* in Ohio Sup. Ct, pp. 1-2, thereupon intervened, and another hearing was held on March 29, 1985. At New Energy's request, the court agreed to expedite matters, and accordingly issued a ruling on April 23, 1985.

The State Defendants asked the Court to find that

"It is conceivable that the Ohio General Assembly may have had several purposes in enacting R.C. § 5735.145 (B), none of which were explicitly declared in the enactment itself. One of these purposes was to provide a cleaner and safer environment for Ohio citizens by encouraging the use of ethanol as a replacement for lead gasoline not only in Ohio but in all states."

JA 44

The Court did not adopt this Proposed Finding. Instead, it found that:

"b. The plaintiff will be significantly damaged by the effect of the legislation;"

"c. The legislature's purpose of promoting domestic industry and to effect the policies of other state to grant reciprocal tax credits, is a legitimate purpose—at least debateably..."

J.St. App. 63a.

The Court also found that "plaintiff is the only producer affected and it would not have been affected if its state legislature had not abolished its tax credit." While noting that "this is a very close case," the court concluded: "Remembering that the legislation receives a strong presumption in favor of its constitutionality, this Court holds that it does not violate the Commerce Clause of the United States Constitution." J. St. App. 65a.

New Energy appealed immediately, but partly because of the death of a judge in August 1985, the Court of Appeals did not rule until May 8, 1986, despite its having granted a motion to expedite. It affirmed the trial court by a 2-1 ruling holding that the Ohio statute did not discriminate but treated all ethanol even-handedly. One judge dissented. See J. St. App. 35a-54a.

New Energy promptly requested the Ohio Supreme Court to review the case, and on an expedited basis. The Court agreed, and on December 26, 1986, in a 4-3 decision, found that the Ohio statute was a forced reciprocity statute that discriminated against out-of-state products.

In the preceding election, however, (November, 1986), two of the incumbent justices, both of whom had been in the majority, were not re-elected. Shortly after the newly elected justices took office, South Point Ethanol moved for a rehearing. The vote of four justices is required for rehearing, and the three dissenters were joined by the newly elected Chief Justice Thomas Moyer in voting for rehearing.<sup>3</sup> Shortly thereafter, certain conflict of interest questions were raised about Chief Justice Moyer's participation in the *New Energy* case, and he recused himself from participating in the rehearing.<sup>4</sup> He denied a motion, however, to disqualify himself *nunc pro tunc*; had he granted the motion, he would not have sat on the motion for rehearing, which would have precluded the requisite four votes.

<sup>3</sup>The other newly elected justice followed the normal practice that a judge not on the court when a case is decided, does not vote on the petition for rehearing.

<sup>4</sup>The details are set forth in the *Akron Beacon-Journal*, March 4, 1987, and March 5, 1987.

On September 2, 1987, two and a half years after the action was instituted, a new 4-3 majority disagreed with the Ohio Supreme Court's prior opinion, and upheld the statute on the ground that it was "not protectionist in purpose or effect," and "it does not interfere with the free flow of interstate commerce," J. St. App. 4a, even though "New Energy is adversely affected." J. St. App. 4a. While it found "the issue of forced reciprocity . . . a thorny problem," J. St. App. 8a, the majority concluded that because "the bulk of ethanol and gasoline sold in Ohio is obtained primarily . . . from Illinois and Tennessee," J. St. App. 9a, and there was not "a complete bar to interstate commerce," J. St. App. 10a, the statute was constitutional. Three justices dissented.

This appeal followed.

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## SUMMARY OF ARGUMENT

1. In an unbroken line of decision, this Court has ruled that mandatory reciprocity laws are facially discriminatory and barred by Article I, section 8, cl. 3 of the United States Constitution, the Commerce Clause. *Sporhase v. Nebraska ex rel. Douglas*, 458 U.S. 941, 957 (1982); *Great A&P Tea Co. v. Cottrell*, 424 U.S. 366 (1976) ("A&P"); cf. *Baldwin v. G.A. F. Seelig, Inc.*, 294 U.S. 511 (1935).

The 1984 forced reciprocity amendment to the Ohio ethanol tax credit is facially discriminatory in the same way, and similarly prohibited by the Commerce Clause. The amendment cannot be upheld simply because a few

other states have such a provision, nor because ethanol from these other states is still eligible to come into Ohio on an even basis. This Court has struck down under the Commerce Clause many statutes that do not impose or produce a complete ban on all out of state business, whether those statutes are absolute bars, as in *AdP*, or discriminatory taxes. This is because mandatory reciprocity creates "preferential trade areas [that are] destructive of the very purpose of the Commerce Clause." *AdP*, 424 U.S. at 380. In this case an Indiana competitor of an Ohio company was effectively ousted from the Ohio market because of the discriminatory tax credit, and there is nothing in the record or any other reason, to think that the sales that the Indiana company might have received did not go to the Ohio competitor, the intervenor-appellee.

2. The Ohio mandatory reciprocal amendment is not justified by a constitutionally valid purpose. The Ohio courts found that the purposes of the amendment were "promoting domestic industry *and* to affect the policies of other states to grant reciprocal tax credits," J.St. App. 63a (emphasis in original). These purposes cannot be furthered by discriminatory legislation. The first purpose, "promoting domestic industry" was clearly intended to assist South Point Ethanol, and such domestic protectionism is clearly unconstitutional. The other purpose, "affecting" the policy of Indiana in order to persuade it to grant reciprocal tax benefits to an Ohio company, is an illegal purpose when sought through discriminatory or other coercive means. Ever since *Baldwin v. Seelig*, it has been undisputed that a state "has no power to project its legislation" into another state to force the latter to adhere to the first state's policies. 294 U.S. at 521. While reciprocity

may be acceptable, "forced reciprocity" is not. *AdP*, 424 U.S. at 378-80. "One state may not put pressure of that sort upon others to reform their economic standards." *Baldwin v. Seelig*, 294 U.S. at 524. If Ohio is unhappy with any action taken by the Indiana legislature, its remedy is not economic retaliation but a lawsuit.

Nor can it be argued that this statute was for the purpose of promoting the health of people in Ohio. There is no record evidence of that and the Ohio courts declined to make such a finding. The limitations that Ohio has put on its tax credit, with respect to not only the source of the ethanol but also with respect to the raw materials from which it is made and the fuel which may be used, also indicate that promoting health by encouraging the use of ethanol was not a significant purpose. Moreover, at the time that the reciprocity amendment was adopted, all the states adjacent to Ohio which might be the source of unhealthy conditions already gave tax credits or other incentives to ethanol production and use.

3. The effect of Ohio R.C. 5735.145(B) is to burden commerce excessively. The Ohio trial court found, and it is undisputed, that the amendment effectively excludes appellant New Energy from the Ohio market, and this has adversely affected it. The fact that other out-of-state producers continue to operate in Ohio is irrelevant.

## ARGUMENT

### I. OHIO R.C. 5735.145(B), THE 1984 AMENDMENT TO THE OHIO ETHANOL TAX CREDIT STATUTE ADDING A FORCED RECIPROCITY CONDITION, CONFLICTS WITH THE DECISIONS OF THIS COURT UNDER THE COMMERCE CLAUSE.

In an unbroken series of decisions on state reciprocity provisions similar to the one at bar, this Court has made it clear that mandatory reciprocity provisions are "facially discriminatory" and are subject to "the strictest scrutiny". *Sporhase v. Nebraska ex rel. Douglas*, 458 U.S. 941, 957 (1982). See also *Great A&P Tea Co. v. Cottrell*, 424 U.S. 366 (1976); cf. *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511 (1935). They are "explicit barrier[s] to Commerce between . . . states." *Sporhase v. Nebraska*, 458 U.S. at 957. Not only are such statutes facially discriminatory, they are coercive and protectionist. See Regan, *The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause*, 84 Mich. L. Rev. 1091, 1272-73, (1986) ("There are not many techniques for forcing locals' interests in foreign markets. But reciprocity requirements are such a technique. When a coercive technique appears by which a state can pursue local preference in regard to foreign markets, use of the technique is no less objectionable just because the market in question is foreign.") See also Smith, *State Discriminations Against Interstate Commerce*, 74 Calif. L. Rev. 1203, 1246 (1986) (facial discrimination subject to strict scrutiny regardless of proof of purpose).

The relevant law on barriers to interstate commerce was summarized by the Court two terms ago in *Brown-*

*Forman Distillers Co. v. N.Y. State Liquor Authority*, 106 S. Ct. 2080, 2084 (1986) as follows:

"When a state statute directly regulates or discriminates against interstate Commerce, or when its effect is to favor in-state economic interests over out-of-state interests, we have generally struck down the statute without further inquiry. [citations omitted] When, however, a statute has only indirect effects on interstate commerce and regulates evenhandedly, we have examined whether the State's interest is legitimate and whether the burden on interstate commerce clearly exceeds the local benefits. *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142, 25 L.Ed.2d 174, 90 S.Ct. 844 (1970). We have also recognized that there is no clear line separating the category of state regulation that is virtually per se invalid under the Commerce Clause, and the category subject to the *Pike v. Bruce Church* balancing approach. In either situation the critical consideration is the overall effect of the statute on both local and interstate activity."

The Court's clearest and most recent statement on reciprocity is in *Sporhase*, where the Court voided a Nebraska law that conditioned withdrawal of local ground water to another state on the destination state's granting of reciprocal rights of withdrawal into Nebraska. Despite the Court's recognition of Nebraska's "legitimate reasons" based on the need "to conserve and preserve for its own citizens this vital resource in times of severe shortage", as well as many other reasons for the Court to sustain the Nebraska statute, the Court found the reciprocity provision to be "facially discriminatory" and subjected it to the strictest scrutiny, which the provision failed to pass.

The Court showed the same hostility toward forced reciprocity in *A&P*, a case very similar to this one. There,

Mississippi allowed milk from another state to be sold in Mississippi only if the other state "accepts Grade A milk and milk products produced and processed in Mississippi on a reciprocal basis." 424 U.S. at 367. When Mississippi tried to defend its statute by claiming it was only trying to protect the health of its citizens, the Court unanimously replied, "To allow Mississippi to insist that a sister State either sign a reciprocal agreement acceptable to Mississippi or else be absolutely foreclosed from exporting its products to Mississippi would plainly invite a multiplication of preferential trade areas destructive of the very purpose of the Commerce Clause. *Dean Milk*, 340 U.S., at 356." 424 U.S. at 380. See also *Russell Stewart Oil Co. v. Illinois*, 85 CH 8959 (Cir. Ct. Cook Cty. May 7, 1986), *appeal pending*; opinions of Attorneys General of Tennessee and Illinois, J. St. App. 68a-77a, and of Idaho and Alabama, *Alcohol Update*, Dec. 21, 1987, p. 2.

The 1984 reciprocity amendment to the Ohio ethanol tax credit is similarly "facially discriminatory" and, as the Ohio Supreme Court acknowledged, is subject to the "strictest scrutiny," J. St. App. 8a, citing *Hughes v. Oklahoma*, 441 U.S. 322 (1979), and *Sporhase*. Like the Mississippi and Nebraska statutes, Ohio explicitly treats out-of-state goods worse than those manufactured in Ohio, unless the other state provides Ohio goods, *i.e.*, South Point ethanol, precisely what Ohio wants to the penny—in this case, a tax credit for ethanol at least equal to that which Ohio gives to ethanol produced by South Point.

The Ohio Supreme Court nevertheless upheld the forced reciprocity provision, apparently on two grounds: The first is that "most of the states near Ohio have recipro-

cal tax credit program, as did Indiana recently . . . [and] if New Energy is successful . . . each state's reciprocal tax program would fall like a row of dominoes." J. St. App. 8a-9a.

Apart from the fact that only a few states have *reciprocity* statutes—the rest give credits but do not exact reciprocity and of the handful that do, only a few, *e.g.*, Ohio, Kentucky and Texas fully enforce the reciprocity agreement<sup>5</sup>—the constitutional significance of this is unclear since "about thirty states" have no greater right to discriminate and force reciprocity on the other twenty, than one state may, with respect to the other forty-nine.

The Ohio Supreme Court's second and weightier reason is its observation that:

"the bulk of ethanol and gasohol sold in Ohio is obtained primarily through interstate commerce, whereby ethanol is shipped into Ohio from Illinois and Tennessee. Thus, New Energy's inability to compete in the Ohio market will not affect the flow of ethanol through interstate commerce into Ohio." J. St. App. 9a.

But this Court has struck down under the Commerce Clause many statutes that do not impose or produce a complete ban on all out-of-state business. The Court explicitly noted in *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 146 (1970), that only one company, and not the entire industry was affected. In *Hunt v. Washington Apple Advertising Comm'n*, 432 U.S. 333 (1977), the impact on the products

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<sup>5</sup>Illinois, Alabama, Idaho and Tennessee do not. See Information Resources, Inc., *U.S. Motor Fuel Legislative and Regulatory Service* (1987); *Alcohol Update*, Dec. 21, 1987, p.2. Indiana never had a reciprocity requirement.

of only one state—Washington—was at issue. In *Lewis v. BT Investment Mgrs., Inc.*, 447 U.S. 27, 32, 39-40 (1980), the statute was actually aimed at only one company. And in *AdP*, Louisiana milk was largely<sup>6</sup> excluded, but some eight states had reciprocity agreements with Mississippi and milk from those states was able to come into Mississippi. See Brief of Appellee in *AdP* 6-7. See also *Miller v. Publicker Industries, Inc.*, — Fla. —, 457 So. 2d. 1374 (Fla. S. Ct. 1984) (foreign producers excluded, but not domestic out-of-state companies).

The speculative assertion that New Energy's exclusion from the Ohio market "will not affect the flow of ethanol" into Ohio—which is mere speculation without any record support whatsoever—is particularly inappropriate in a Commerce Clause challenge to a reciprocity provision. Reciprocity creates preferential trade enclaves, in which firms from other states may enter, or compete on an equal footing with the in-stater, only in return for favorable treatment for the in-stater in those other states. Thus, if Indiana gives no credit, Illinois gives only a 1¢ credit, and Ohio and Kentucky each give a 4¢ credit, then (1) Indiana businesses are at a competitive disadvantage in the other three states; (2) Illinois businesses would be able to compete on an even basis only in Indiana and Illinois; and (3) Ohio and Kentucky businesses will have an advantage in the Ohio and Kentucky markets. See also *Halliburton Oil*

<sup>6</sup>Because of a "grandfather clause", even some milk from Louisiana and Alabama which had no reciprocity agreements with Mississippi continued to come in. *Great A&P Tea Co. v. Cottrell*, 383 F.Supp. 569, 572 (1974). This is another instance where the Ohio Supreme Court was factually mistaken. J. St. App. 11a ("no Louisiana milk entered Mississippi").

*Well Cementing Co. v. Reily*, 373 U.S. 64, 72 (1973); *Columbia Steel Co. v. State*, 30 Wash. 2d 658, 662-64 (1948), cited in *Armco v. Hardesty*, 467 U.S. 638, 645 n.8. (1984). Such "preferential trade areas [are] destructive of the very purpose of the Commerce Clause." *AdP*, 424 U.S. at 380. See also *Dean Milk Co. v. Wisconsin*, 340 U.S. 349, 356 (1951).<sup>7</sup>

The discriminatory effect of the Ohio reciprocity statute is clear: an Indiana competitor of an Ohio company was ousted from the Ohio market. Speculation as to who took that share is baseless and immaterial, for regardless of the *capacity* of other interstate competitors, who were expanding their business in other states, there is no evidence for believing that ADM or Pekin, rather than South Point, got New Energy's business. To the contrary, Marathon Oil Co. advised the Ohio Supreme Court, in its *amicus curiae* brief, that it wanted to buy from an Indiana producer, because "transportation logistics and expense" precluded it from buying from producers in Tennessee, Kentucky and Illinois. *Amicus Curiae Brief of Marathon Petroleum Co. Urging Reversal*, p.4. The only alternative ethanol source was South Point. Unlike *Exxon*, where a dealer could buy oil and gasoline *only* in interstate com-

<sup>7</sup>Mandatory reciprocity has also been struck down under the Privileges and Immunities Clause, Art. IV, § 2, *Austin v. New Hampshire*, 420 U.S. 656, 666-67 (1975); *Travis v. Yale & Towne Mfg. Co.*, 252 U.S. 60, 82 (1970), and though that clause is not applicable to this case, the goals of the Privileges and Immunities Clause are similar to those of the Commerce Clause. See *Hughes v. Oklahoma*, 441 U.S. 322, 334 (1979); *Hicklin v. Orbeck*, 437 U.S. 518, 531-32 (1978); *Baldwin v. Montana Fish & Game Comm'n*, 436 U.S. 371, 379 (1978).

merce, here at least some customers could turn to a domestic competitor like South Point.

As the Court noted in *Exxon*, "if the effect of a state regulation is to cause local goods to constitute a larger share, goods with an out-of-state source to constitute a smaller share, of the total sales in the market—as in *Hunt*, 432 U.S., at 347, 97 S.Ct., at 2443 and *Dean Milk*, 340 U.S., at 354, 71 S.Ct., at 297—the regulation may have a discriminatory effect on interstate commerce." 437 U.S. at 126 n.16. Here, there is no reason not to think that the result of the reciprocity amendment was what one would normally expect: that "the effect of [Ohio R.C. 5735.145(B)] is to cause local goods to constitute a larger share, and goods with an out-of-state source to constitute a smaller share" of the Ohio ethanol market.

The Ohio Supreme Court also seemed to suggest that prior decisions of this Court banning the kind of legislation represented by the Ohio reciprocity amendment, were somehow inapplicable because in those cases the "ban" on interstate commerce was in the form of an absolute prohibition on entry, whereas here it is in the form of a discriminatory tax. But this Court has rejected any distinction between (a) taxes that make out-of-state entry difficult or impossible, on the one hand, and (b) absolute bans, on the other, and has treated the two forms of barrier identically. See *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318 (1979). In *Nippert v. Richmond*, 327 U.S. 416, 426 (1946) discussing barriers to entry the Court said, "Nor may the prohibition be accomplished in the guise of taxation, which produces the excluding or discriminatory effect." See also, *Bacchus Imports Ltd. v.*

*Dias*, 468 U.S. 263 (1984); *Welton v. Missouri*, 91 U.S. 272 (1876); *Darnell & Sons v. Memphis*, 208 U.S. 113 (1908); *Best & Co. v. Maxwell*, 311 U.S. 454 (1940); *Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64 (1963). As Chief Justice John Marshall said over 150 years ago, "The power to tax is the power to destroy," *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 431 (1819), and here Ohio's tax has destroyed New Energy's ability to compete in the Ohio market.

That the discrimination is in the form of a credit is equally immaterial. *Westinghouse Elec. Corp. v. Tully*, 466 U.S. 388, 404-05 (1984). The trial court found, and it is undisputed, that Ohio's forced reciprocity amendment has a "major impact on its [plaintiff's] business in Ohio . . . [for] in all likelihood, no dealer will purchase plaintiff's product because it is not subject to the tax credit." J. St. App. 58a, 62a; see also the Ohio Supreme Court's reference to "New Energy's inability to compete in the Ohio market." J. St. App. 9a. That is sufficient. See *Brown-Forman Distillers Co. v. N.Y. State Liquor Authority*, 106 S. Ct. at 2084, ("the critical consideration is the overall effect on both local and interstate activity"). As the dissent below observed:

In numerous cases, the United States Supreme Court has invalidated discriminatory state taxes without requiring that they be so drastic as to erect an impenetrable barricade to Commerce at the state border. See, e.g., *Tyler Pipe Industries, supra*; *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984); *Armco, supra*; *Mary-*

*land v. Louisiana*, 451 U.S. 725 (1981); *Boston Stock Exchange*, *supra*.<sup>3</sup>

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<sup>3</sup>State regulations, as opposed to taxes, also need not effect a total ban upon importation to impermissibly burden or discriminate against interstate Commerce. See *Hunt v. Washington State Apple Advertising Comm.*, 432 U.S. 333 (1977), wherein the Court invalidated a facially neutral North Carolina statute requiring closed containers of out-of-state apples to bear no quality grade markings showing other than the applicable federal grade. Such regulation plainly did not completely ban the importation of out-of-state apples, but it did put their growers at a competitive disadvantage.

J. St. App. 17a-18a.

Such a "competitive disadvantage" on some out-of-state businesses, or the deprivation of a competitive advantage, *Hunt*, 432 U.S. at 351, *Baldwin v. Seelig*, *supra*, is enough to condemn a statute.

Nor is it relevant how great the disadvantage. As this Court said in *Westinghouse Elec. Corp. v. Tully*, 466 U.S. at 407:

When a tax, on its face, is designed to have discriminatory economic effects, the Court "need not know how unequal the tax is before concluding that it unconstitutionally discriminates." *Maryland v. Louisiana*, 451 U.S. [725] at 760.<sup>13</sup>

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<sup>13</sup>The extent of the discrimination does not affect our analysis.

Reciprocity requirements also have an additional vice, noted by the Attorney General of Tennessee in his opinion ruling that an ethanol reciprocity tax credit statute is unconstitutional: "The reciprocity statute does not mitigate the possibility of discrimination against interstate Commerce because gasohol manufacturers do not dictate their states' taxation structures," J. St. App. 71a, (though

events in Ohio suggest the possibility that this is not always so.) New Energy was dismayed by the Indiana decision to repeal the ethanol tax credit, and its trial counsel noted its unhappiness. JA 69, 103 Similarity, "A&P attempted but failed to obtain the required reciprocity agreement from the Louisiana health authorities." 424 U.S. at 369 n.1.

This helplessness makes it particularly inappropriate for the Ohio Supreme Court and the lower courts to declare that if Indiana chose to repeal its credit and provide production grants, and "an Indiana energy producer is put at a disadvantage in maintaining its share of the Ohio market, so be it." J. St. App. 9a.<sup>8</sup> See also the lower court suggestions to the same effect. J. St. App. 45a-46a; 65a. This Court was obviously not impressed with such arguments when they were made in *A&P*, see *Great A&P Tea Co. v. Cottrell* 383 F. Supp. 569, 575 n.2 (S.D. Miss. 1874) (3 judges), and they are no more impressive here.<sup>9</sup>

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<sup>8</sup>The Indiana production grant was eliminated as of July 1, 1986.

<sup>9</sup>The Court has also stressed "that a tax must have what might be called internal consistency—that is, the [tax] must be such that, if applied by every jurisdiction, 'there would be no impermissible interferences with free trade.'" *Armco v. Hardesty*, 467 U.S. at 644. See also *Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue*, 107 S. Ct. 2810, 2820 (1987); *American Trucking Ass'ns, Inc. v. Scheiner*, 107 S. Ct. 2829 (1987). Here, if reciprocity were insisted upon by every state, free trade areas would be created in which only those businesses whose state gave exactly the same amount of tax credit to out-of-staters would be able to compete fully in each other's states. More-

(Continued on following page)

## II. THE OHIO FORCED RECIPROCITY AMENDMENT IS NOT JUSTIFIED BY A CONSTITUTIONALLY VALID PURPOSE.

Appellees, and particularly the State of Ohio, have tried to argue that the purpose of the 1984 amendment requiring reciprocity was the promotion of health; Appellees Limbach and Withrow submitted a Proposed Finding to that effect.<sup>10</sup>

The trial court did not make such a finding. Instead, it found two other purposes: "promoting domestic industry *and* to affect the policies of other states to grant reciprocal tax credits." J. St. App. 63a (emphasis in original). The trial court considered these "debatedly" legitimate, but in the context of a mandatory reciprocity provision, they are not even that.

"Promoting domestic industry" is a facially obvious purpose of Ohio R.C. 5735.145 (B), and the record rein-

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(Continued from previous page)

over, the effect would vary at different times, and would thus "depend on the shifting incidence of the varying tax laws of the various states at a particular moment." The effect of Ohio R.C. 5735.145(B) on Indiana producers would have been different in 1983, when Indiana gave a credit, from what it was in 1984, when Indiana did not, and the effect on Illinois producers is different now that Illinois has reduced its credit, from what it was before the reduction. Moreover, Ohio is reducing its credit over the next few years, and this will also affect the situation. "The immunities implicit in the Commerce Clause and the potential taxing power of a state could hardly be made to depend, in the world of practical affairs, on such variable relationships." *Freeman v. Hewitt*, 329 U.S. 249, 256 (1946); *Armco v. Hardesty*, 467 U.S. at 648; *Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue*, 107 S. Ct. at 2817 n.11.

<sup>10</sup>JA44.

forces that. But that implies nothing as to the legitimacy of the statute, for everything turns on the means, and discrimination against out-of-state business is not an acceptable means.<sup>11</sup> States may not 'build up [their] domestic commerce by means of unequal and oppressive burdens upon the industry and business of other States.' *Guy v. Baltimore*, 100 U.S. 434, 25 L. Ed. 743 (1880).'' *Bacchus Imports v. Dias*, 468 U.S. at 272; see also *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. at 329.

Ohio's reasons for wanting to "promote" South Point Ethanol, the only member of the "domestic [ethanol] industry" are obvious and indeed indisputable, as is the fact that the ethanol tax credit statute was amended in 1984 to require reciprocity for that very purpose.

South Point has an annual capacity of some 60,000,000 gallons of ethanol, of which 41% was sold in the Ohio market in 1984, or some 22-23 million. JA 132 New Energy, with approximately the same capacity, considered Ohio one of its two potential major markets, for obvious reasons of proximity and low freight costs. New Energy planned to sell approximately 1.7 million gallons a month to wholesalers and retailers in Ohio or about 20.4 million gallons annually (JA 63-64), and already had contracts. New Energy thus presented a direct competitive threat to South Point.

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<sup>11</sup>Promoting domestic industry by discriminatory taxes is unacceptable even under the looser rational basis standards of the Equal Protection Clause. *Metropolitan Life Ins. Co. v. Ward*, 470 U.S. 869 (1985).

Nor is South Point Ethanol simply another private business to the Ohio legislature. The company, which was formed in 1981 with an investment of \$120 million when the Ohio economy was seriously depressed, provides 191 jobs in an area with some of the highest unemployment rates in the state. JA 128 South Point has a payroll of \$6 million annually, and it provides additional employment for 20-40 outside consultants. South Point also buys a great deal of corn from Ohio farmers, and uses 180,000 tons of coal per year, much of which is likely to come from Ohio. Its overall budget is almost \$100 million. JA 150, 130 Finally, the State of Ohio Public Employees Retirement System loaned South Point \$23.5 million to retrofit and operate its plant.

All of this was brought to the attention of the Ohio legislature in 1984 in support of the amendment, as follows:

“Q. Did you tell them about the benefits of the South Point Plant?”

“A. Yes, I stressed the development of the South Point project and used a table similar to defendant’s Exhibit C to stress the economic impact of the South Point Plant.” (Testimony of South Point General Manager Lauren Hill.)

JA 136

Ohio’s “promoting [this particular] domestic industry” against a new competitive threat is thus very understandable.

Protection against New Energy’s competition in Ohio was not the sole purpose, however, as the trial court found. South Point, which apparently saw neighboring Indiana with its very substantial ethanol consumption as a very

rich market for its ethanol, was about to lose a sales credit in that market, as a result of the oil companies’ success in getting the Indiana credit repealed. It therefore sought to put intense pressure on New Energy to “affect” the policy of Indiana and to persuade it “to grant reciprocal tax benefits” to South Point.

Here again, it is indisputed that this was the purpose. As witnesses for both New Energy and South Point Ethanol testified, South Point Ethanol, through its General Manager Lauren Hill, was “lobbying heavily for it [R.C. 5735.145(B)] so they would put pressures on Indiana and perhaps on me [New Energy’s President] for some number in Indiana for them at the pump.” JA 123 South Point General Manager Hill, who testified for South Point Ethanol at the hearings on the 1984 amendment, confirmed this:

“Q. Basically your support of the reciprocity clause was for the purpose of having Ohio legislation that would put pressure on Indiana to pass legislation?”

“A. Well, my support of the, including the reciprocity clause with all of these changes was as an incentive to all states to enact all legislation that would promote the sale of ethanol in their states.”

JA 139 *See also* JA 136. Obviously, the “incentive” was the “pressure” created by putting an Indiana ethanol producer like New Energy at a competitive disadvantage with South Point Ethanol in the Ohio ethanol market, unless the Indiana legislature did what Ohio wanted it to do. And if New Energy failed to persuade the Indiana legislature to reinstate the credit, New Energy would simply

lose the Ohio market, hardly something to upset either the Ohio legislature or South Point.

Indeed, Indiana was probably the only target since South Point's other major market—Kentucky—already had a tax credit at least as high as Ohio's, as did Tennessee and Illinois, the two other states, in which ethanol was produced and sold in Ohio, and in which South Point sold. Only Indiana no longer had any credit, and thus only Indiana was likely to be immediately affected by the legislature.

"Affect[ing] the policies of other states" is not an inherently illegal purpose. But when it is sought through discriminatory or other coercive means, it is unacceptable under the Commerce Clause. Ever since *Baldwin v. Seelig*, it has been undisputed that a state "has no power to project its legislation into another state to force the latter to adhere to the first state's policies." 294 U.S. at 521. While reciprocity may be acceptable, "forced reciprocity" is not. *AdP*, 424 U.S. at 378-80. "One state may not put pressure of that sort upon others to reform their economic standards." *Baldwin v. Seelig*, 294 U.S. at 524. See also *Brown-Forman Distillers v. N.Y. State Liquor Auth.*, *supra* (New York cannot force producers in other states to give up their competitive advantage).

The 1984 amendment may also be seen as retaliation against the Indiana-based New Energy for repeal of the Indiana credit and enactment of a production grant: the Ohio legislation resulted from the Indiana repeal and was designed to overturn it. Such "protectionist retaliation" is clearly forbidden by the Commerce Clause. *AdP*, 424

U.S. at 379-80; Regan, 84 Mich. L. Rev. at 1114-15, 1137; Eule, *Laying the Dormant Commerce Clause to Rest*, 91 Yale L. J. 425 (1982). There is obviously nothing wrong with either Indiana's repeal of the credit, or its creating a production grant, and even if there were, Ohio's remedy is a lawsuit, not discriminatory legislation. *AdP*, 424 U.S. at 379-80; *Sporhase v. Nebraska*, 458 U.S. at 958 n. 18.

In the courts below, the State and South Point Ethanol tried to argue that the amendment was passed to increase the use of ethanol and thereby reduce pollution in Ohio. It will be noted that neither the trial Court nor the Court of Appeals accepted this contention, despite the state defendant's Proposed Finding (and even that only suggested it was "conceivable") and in the Ohio Supreme Court there is only a passing reference, somewhat ambiguously suggesting this as one of the purposes.<sup>12</sup>

The record is barren of any support for this contention apart from a few almost casual references to the advantages of lead-free gasoline. Not only did the trial court and the Court of Appeals decline to find this as a purpose,<sup>13</sup> but it is patently implausible that this was a purpose of the forced reciprocity amendment. If Ohio wants to encourage the use of ethanol, Ohio would not exclude any

<sup>12</sup>See the reference to "Ohio's interest in reducing lead pollution." J. St. App. 10a.

<sup>13</sup>The trial court's finding of purposes, quoted above, came immediately after stating appellees' health purpose claim and pointedly omitted health among its findings, while the Court of Appeals nowhere mentioned health as a purpose. See J. St. App. 42a (stating the purposes).

ethanol producer from *anywhere*, by denying the credit. Nor would it deny the credit to ethanol businesses whose states have used methods other than a tax credit to promote the use of ethanol. Moreover, Ohio would not insist that any tax credit granted by another state be as high as Ohio's for the other state's ethanol business to avoid being put at a competitive disadvantage in Ohio.

Indeed, if Ohio were really serious about using the credit to encourage the use of ethanol, it would not limit the credit to ethanol made with grain—which is produced in Ohio—and exclude ethanol made from beet or cane sugar, *i.e.*, ethanol not made in Ohio. It would not limit its credit to ethanol made from plants fired with coal—which Ohio mines—or wood, and exclude ethanol made from plants that are gas-fired. And it would not limit the grant to plants with a capacity below 200,000,000 gallons.

The fact is that ethanol use has grown even in states without credits. Of the states that use the most ethanol, Indiana gives none and most give only 1¢ (Iowa and Illinois). Ohio itself is not even among the states in which ethanol accounts for 20% or more of the market share, see p. 8 *supra*, although most of its neighbors, including states with no credit like Indiana and Michigan, and states with a very low credit, like Illinois, are among that group. This health argument is further undermined by the fact that if Ohio's purpose was to induce those states with companies that sold in Ohio to encourage the use of ethanol by giving a credit, it was unnecessary. As the Supreme Court of Ohio said, the major sellers in Ohio were from Illinois, Tennessee and Indiana, see J. St. App. 9a, and at the time reciprocity was introduced into the Ohio tax structure, Illinois and Tennessee already gave

credits to Ohio ethanol at least as high as Ohio's credits. See App. 1a. Only Indiana *could* be affected, and Indiana was encouraging ethanol use in other ways. Indeed, at the time of suit, Indiana already had some 30% of its fuel in gasohol, JA 69-70, despite elimination of the credit, and it has always been among the highest users. See CRS Study 4. Thus, the Ohio reciprocity condition was unnecessary for any purpose but the obvious one: to help South Point compensate for lost profits in the Indiana market, where, by the time of trial, six months after New Energy began operations and three months before the scheduled repeal of the Indiana tax credit, South Point's sales had fallen by about one-third. JA 132-33

As the Court noted in *AdP*, *Hunt*, *Westinghouse*, and many other cases, the State's claim that it is furthering an acceptable purpose would be more persuasive if the provision in question actually implemented the asserted goal.

Even if there were a legitimate health goal, it must be sought by the "least restrictive alternative," in keeping with "the strictest scrutiny," applicable to such facially discriminatory legislation. *Sporhase v. Nebraska*, 458 U.S. 958; *Dean Milk*, 340 U.S. at 354; *Baldwin v. Seelig*, 294 U.S. at 524; *Deukmejian v. Nat'l Meat Ass'n*, 734 F.2d 656 (9th Cir. 1984), *aff'd*, 105 S.Ct. 768 (1985). As indicated above, there are many other ways to promote the use of ethanol that are less harmful to interstate Commerce.

### III. THE EFFECT OF R.C. 5735.145(B) IS TO BURDEN COMMERCE EXCESSIVELY.

Even if, unlike R.C. 5735.145(B), a statute regulates evenhandedly and treats all equally, there may still be a

violation of the Commerce Clause if "the burden on interstate Commerce exceeds the local benefits." *Pike v. Bruce Church*, 397 U.S. at 142. The only legitimate "local benefits" that are even remotely relevant are health-related, since protecting local industry at the expense of interstate commerce, or trying to force other states to provide benefits to that local industry, are each illegitimate purpose. Here, the burden far exceeds any possible health benefits for the reasons discussed above.

The Ohio Supreme Court sought to buttress its conclusion that there was no excessively harmful effect on commerce, a contention discussed under Point I hereof, by positing a hypothetical case in which Ohio R.C. 5735.145(B) was enacted, even though no Ohio firm produced ethanol. In that case, all the ethanol would come from out-of-state firms entitled to the full discount and "producers from states without a reciprocal program would, as appellant, still be at a disadvantage"—a recognition incidentally, that the statute does disadvantage appellant. If an Ohio producer then enters the market, it is on an even basis with the other competitors in the market, and such "identity of treatment for in state and out-of-state producers is the very essence of the Supreme Court's standard for 'even-handedness.'" J. St. App. 8a.

Hardly. Apart from the fact that the forced reciprocity amendment was passed with an Ohio producer already in the market, able and indeed likely to benefit (the trial court found, of course, that the very purpose of the statute was to benefit an existing Ohio producer) the Ohio Supreme Court's logic would explain away every reciprocity case like *AdP*, as well as other cases such as *Hunt*, *Lewis v. BT Inv. Mgrs., Inc.*, and *Baldwin v. Seelig*, where a

state discriminates against some but not all interstate commerce. Thus, if there were no North Carolina apple growers, only Washington apples would be at a disadvantage and apples from other states outside North Carolina would occupy the market on an even basis with North Carolina's apples when the latter enter the market. Similarly, if there were no Mississippi milk producers, milk from states that accept the reciprocity condition would come into Mississippi, but not milk from those states like Louisiana and Alabama that had refused to do so, and when Mississippi started to produce milk, producers from the first group of states would be treated the same as Mississippi producers. And finally, if there were no milk producers in New York, producers from states where the milk was priced no lower than New York's price floor would occupy the New York market, and the subsequent entry of a New York producer would also treat them all "even-handedly."

The fact that there is an Ohio competitor here already in the market, able and indeed likely to benefit, distinguishes this case from the statute in *Exxon Corp. v. Maryland*, which was passed in the absence of any Maryland competitor and was in no way designed to help local competitors, and could not affect the flow of interstate gasoline. See Note, *The Supreme Court, 1977 Term*, 92 Harv. L. Rev. 66, 71n.40 (1978). The statute in *Exxon* was designed for certain legitimate economic purposes in no way related to competition between in-state and out-of-state competitors. Whatever incidental harm there was to interstate commerce was not only minor and fortuitous but probably unavoidable, if the service station industry was to be restructured so as to exclude refiners and producers,

*no matter what their home state*, from service station ownership. The statute therefore met the "least drastic alternative" requirement of *Dean Milk*. The same holds for *Minn. v. Clover Leaf Creamery, Co.*, 449 U.S. 456 (1981) and *CTS Corp. v. Dynamics Corp.*, 107 S. Ct. 1637 (1987), which also involve even-handed treatment that is indifferent to the source of the competing entities. Under the Ohio statute, by contrast, the burden on interstate competitors is the purpose, effect and explicit target.

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### CONCLUSION

The decision of the Supreme Court upholding the 1984 mandatory reciprocity amendment, Ohio Rev. Code 5735.145(B), should be reversed and the amendment should be held unconstitutional under Art. I, § 8, cl. 3 of the Constitution.

Respectfully submitted,

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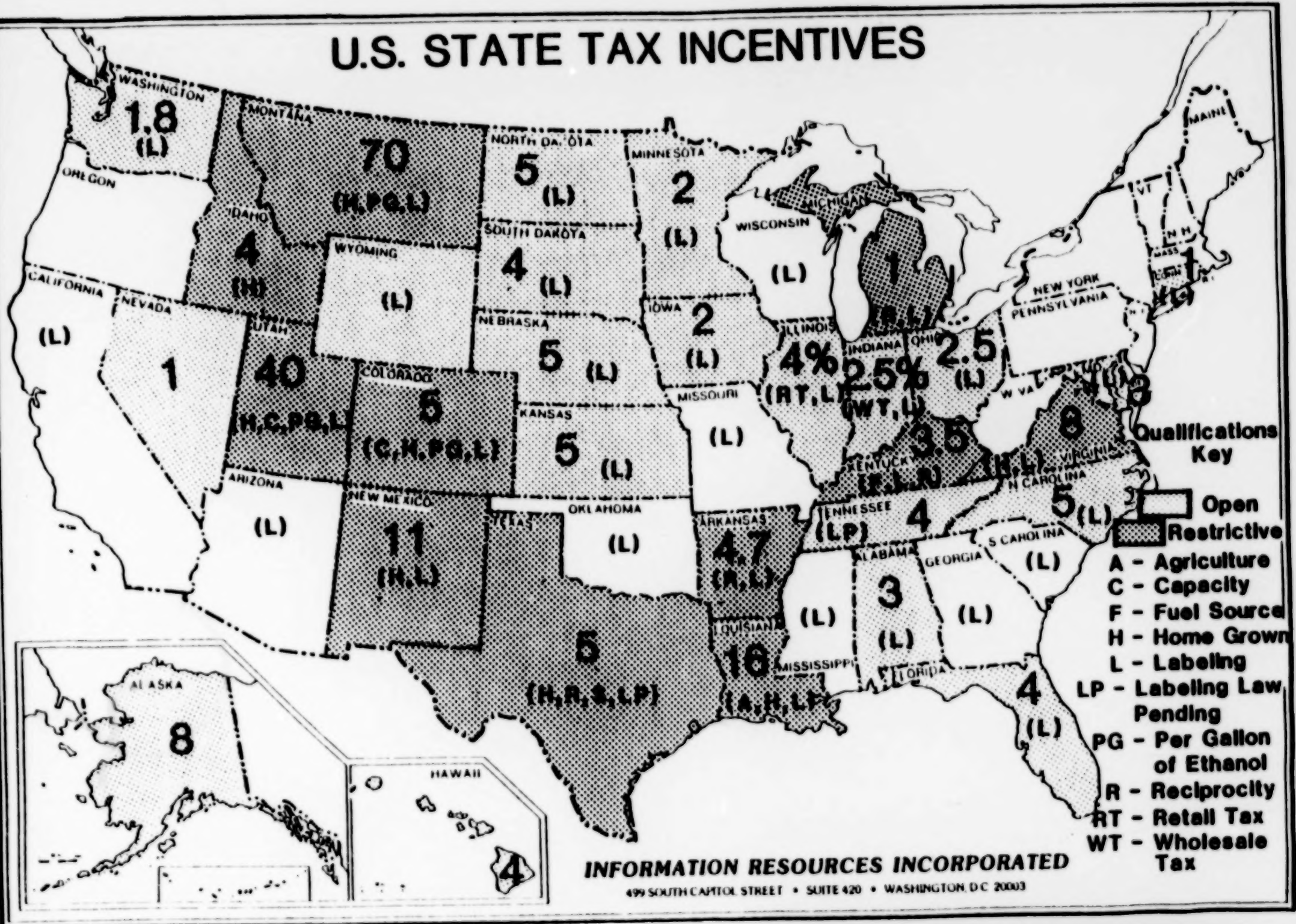
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January 15, 1987

### APPENDIX

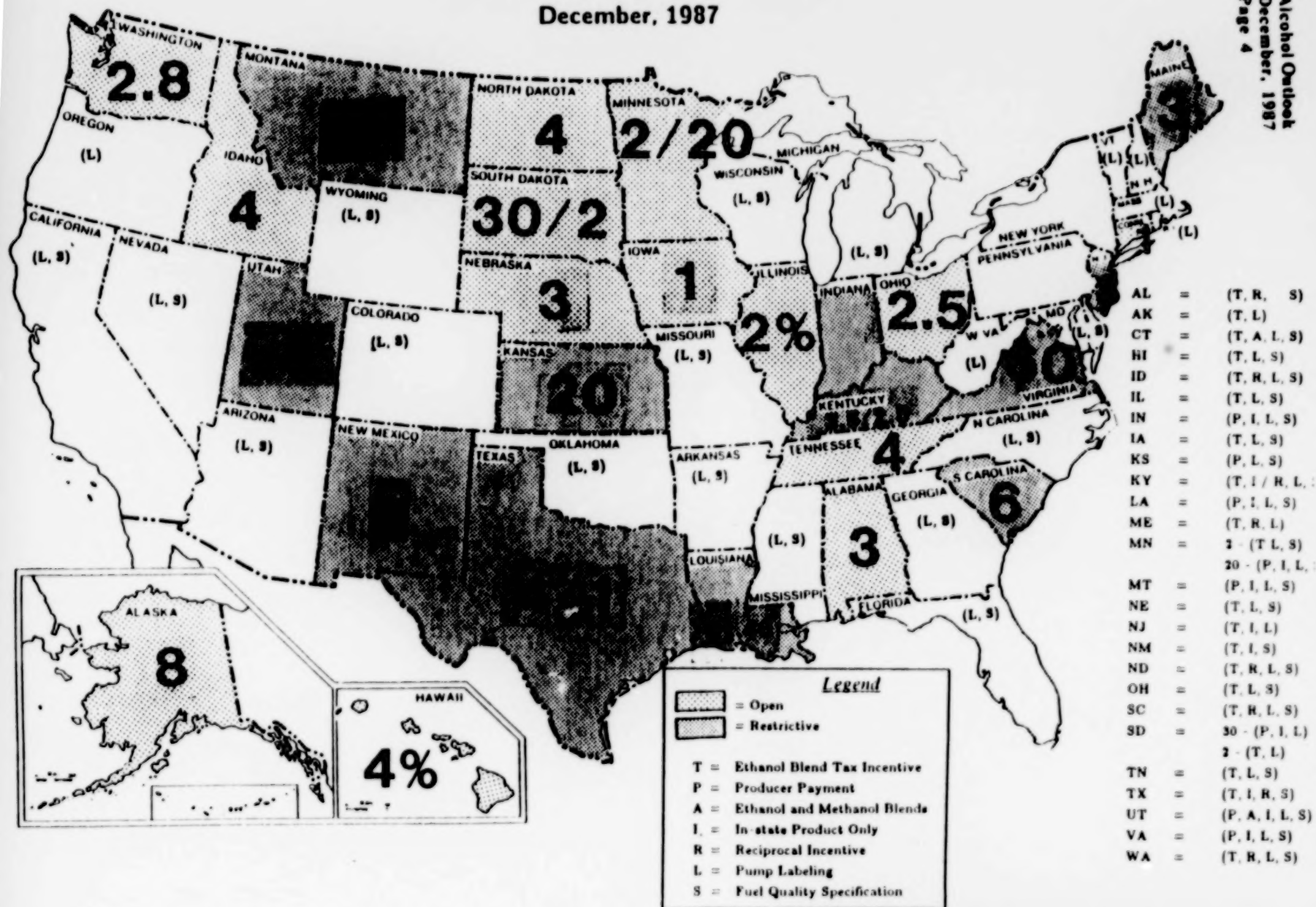
# U.S. STATE TAX INCENTIVES



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## State Fuel Incentives &amp; Regulations

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**5735.145. Credits for use or sale of qualified fuels.**

(A) AS USED IN THIS SECTION AND SECTIONS 5735.13, 5735.14, 5735.141, 5735.142, 5735.146, AND 5735.17 OF THE REVISED CODE.

(1) “[qualified]\* QUALIFIED fuel” means [alcohol]\* ETHANOL that is to be combined with gasoline to create a blend of not more than ten per cent by volume of [alcohol and]\* ETHANOL AND THAT WHEN SO BLENDED is used, sold or distributed as a motor vehicle fuel. [“Alcohol” includes ethanol and methanol but does not include alcohol produced from natural gas or petroleum. “Alcohol” does include methanol produced from coal.]\*

(2) “ETHANOL” MEANS:

(a) ETHANOL PRODUCED IN A MANUFACTURING FACILITY WITH AN ANNUAL PRODUCTION CAPACITY OF LESS THAN TWO MILLION GALLONS FROM WOOD OR THE GRAIN OF A CEREAL GRASS AND DENATURED IN ACCORDANCE WITH UNITED STATES BUREAU OF ALCOHOL AND TAX REGULATIONS; OR

(b) ETHANOL PRODUCED THROUGH A COAL-FIRED PROCESS FROM WOOD OR THE GRAIN OF A CEREAL GRASS AND DENATURED IN ACCORDANCE WITH UNITED STATES BUREAU OF ALCOHOL AND TAX REGULATIONS.

(3) “FEDERAL GASOHOL CREDIT” MEANS THE AMOUNT PER GALLON ON THE LAST DAY OF EACH MONTH BY WHICH THE FEDERAL TAX ON GASOLINE EXCEEDS THE FEDERAL TAX ON GASOHOL IMPOSED UNDER 26 U.S.C.A. 4081.

(4) “QUALIFIED FUEL CREDIT” MEANS THIRTY-FIVE CENTS PER GALLON OF QUALIFIED

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\* Bracketed material deleted.

FUEL MINUS THE AMOUNT PRODUCED BY THE FOLLOWING COMPUTATIONS:

(a) SUBTRACT FIVE CENTS FROM THE FEDERAL GASOHOL CREDIT. IF THE DIFFERENCE IS A NEGATIVE NUMBER, THE QUALIFIED FUEL CREDIT SHALL BE THIRTY-FIVE CENTS, AND NO FURTHER COMPUTATIONS SHALL BE REQUIRED.

(b) MULTIPLY THE DIFFERENCE THUS OBTAINED BY TEN. IF THE PRODUCT EXCEEDS THIRTY-FIVE CENTS, THE QUALIFIED FUEL CREDIT SHALL BE ZERO.

THE TAX COMMISSIONER SHALL MAKE SUCH COMPUTATIONS ON THE FIRST DAY OF EACH MONTH, AND THE RESULT OF SUCH COMPUTATIONS SHALL BE THE CENTS PER GALLON QUALIFIED FUEL CREDIT FOR THAT MONTH AND EACH MONTH THEREAFTER UNTIL THE AMOUNT OF SUCH CREDIT IS CHANGED BY THE COMPUTATIONS REQUIRED BY THIS DIVISION.

(B) THE QUALIFIED FUEL OTHERWISE ELIGIBLE FOR THE QUALIFIED FUEL CREDIT SHALL NOT CONTAIN ETHANOL PRODUCED OUTSIDE OHIO UNLESS THE TAX COMMISSIONER DETERMINES THAT THE FUEL CLAIMED TO BE ELIGIBLE FOR CREDIT CONTAINS ETHANOL PRODUCED IN A STATE THAT ALSO GRANTS AN EXEMPTION, CREDIT OR REFUND FROM SUCH STATE'S MOTOR VEHICLE FUEL EXCISE TAX OR SALES TAX FOR SIMILAR FUEL CONTAINING ETHANOL PRODUCED IN OHIO; PROVIDED HOWEVER, THAT SUCH CREDIT SHALL NOT EXCEED THE AMOUNT OF THE CREDIT ALLOWABLE FOR QUALIFIED FUEL CONTAINING ETHANOL PRODUCED IN OHIO.

(C) Any dealer in motor vehicle fuel shall receive a credit on each gallon of qualified fuel used, sold, or distributed by the dealer and on which the dealer is liable for

the taxes imposed by sections 5735.05, 5735.25, 5735.29, and 5735.30 of the Revised Code. To receive a credit, the dealer shall certify on the monthly report required by section 5735.06 of the Revised Code the number of gallons of qualified fuel used, sold, or distributed during the month to which the report applies and upon which such taxes are imposed. After computation of the amount of the tax in accordance with division (B) of section 5735.06 of the Revised Code, the number of gallons of qualified fuel used, sold, or distributed during the month to which the report applies and included in the gallons of motor vehicle fuel upon which the tax is imposed shall be multiplied by [thirty-five cents.]\* THE CENTS PER GALLON QUALIFIED FUEL CREDIT APPLICABLE TO THAT MONTH. The resulting product shall be subtracted from the tax computed under division (B) of section 5735.06 of the Revised Code and shall constitute the credit provided by this section.

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\* Bracketed material deleted.

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No. 87-654

Supreme Court, U.S.

FILED

FEB 25 1988

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CLERK

**In the Supreme Court of the United States**

**OCTOBER TERM, 1987**

**NEW ENERGY COMPANY OF INDIANA,**

*Appellant,*

v.

**JOANNE LIMBACH, TAX COMMISSIONER  
OF OHIO, MARY ELLEN WITHROW,  
TREASURER OF OHIO, AND  
SOUTH POINT ETHANOL,**

*Appellees.*

*On Appeal from the Supreme Court of Ohio*

**BRIEF OF APPELLEE SOUTH POINT ETHANOL**

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## QUESTION PRESENTED

Whether an Ohio statute violates the Commerce Clause by providing that a special incentive to fuel dealers designed to encourage the production and use of ethanol in Ohio and other states is inapplicable to fuel containing ethanol produced in a state that provides no similar incentive for fuel containing ethanol produced in Ohio, despite the statute's lack of either a protectionist purpose or a detrimental effect on interstate commerce.

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**In the Supreme Court of the United States**

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**NEW ENERGY COMPANY OF INDIANA,**

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TREASURER OF OHIO, AND  
SOUTH POINT ETHANOL,**

*Appellees.*

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*On Appeal from the Supreme Court of Ohio*

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**BRIEF OF APPELLEE SOUTH POINT ETHANOL**

At issue on this appeal is the validity of Ohio Rev. Code § 5735.145(B), which provides that a special incentive to fuel dealers designed to encourage the production and use of ethanol in Ohio and other states is inapplicable to fuel containing ethanol produced in a state that does not provide a similar incentive for ethanol produced in Ohio. Appellant New Energy Company of Indiana ("New Energy") has abandoned challenges based on the Privileges and Immunities and Equal Protection Clauses of the United States Constitution and appeals only on the theory that § 5735.145(B) offends the Commerce Clause. Because New Energy failed to prove that § 5735.145(B) has either a protectionist purpose or a detrimental effect on interstate commerce,

this Court should affirm the decision of the Supreme Court of Ohio rejecting New Energy's Commerce Clause challenge.

## STATEMENT

### A. The Ethanol Industry

Resolution of New Energy's claim that § 5735.145(B) contravenes the Commerce Clause requires an understanding of the nature of the commerce at issue. The trial court heard extensive testimony concerning the structure and economics of the country's emerging ethanol industry. This testimony made clear that the market for ethanol is driven, not by private market forces, but by governmental policies designed artificially to stimulate its production and use. The commerce in question, in other words, is dependent for its existence upon the very form of governmental incentives at issue on this appeal.

Ethanol is a form of alcohol which has increasingly been recognized as a beneficial fuel additive to enhance the octane rating of gasoline without contributing additional lead emissions into the environment (Findings 9, 10, J.A. 25).<sup>1</sup> Because it is a cost-effective and environmentally benign replacement for lead in gasoline, ethanol is the most promising octane-boosting fuel additive currently available. (Finding 10, J.A. 25). In addition, because ethanol is derived primarily from corn, it provides a market for the sale of surplus corn. (Findings 9, 10, J.A. 25). Other benefits resulting from the use of ethanol include boosting rural economies and reducing dependence on foreign oil. (J.A. 51, 58-59).

<sup>1</sup> J.A. refers to the Joint Appendix. J.S.A. refers to the Appendix to Appellant's Jurisdictional Statement.

Despite the many advantages associated with ethanol use, the evidence at trial made clear that fuel made from gasoline blended with ethanol ("gasohol") cannot compete with gasoline without government support. New Energy's chief executive officer described the economics of ethanol production and stated flatly that "[u]nfortunately a gallon of ethanol is far more costly than a gallon of gasoline at this time." (J.A. 64). In a free market, ethanol producers could not sell their product at a price sufficient to cover their production costs; if the price of ethanol reflected the cost of producing it, consumers would purchase regular gasoline rather than gasohol, and commerce in ethanol would come to a halt. (J.A. 63-65, 71-77, 147-149).

Recognizing that private market forces do not provide a sufficient incentive for using ethanol as a motor vehicle fuel additive and that such market forces alone would not generate the substantial economic and noneconomic benefits of ethanol use, the federal government and a number of states initiated programs to encourage ethanol production and use. (Findings 10, 11, 13, New Energy Finding 11, J.A. 25-26, 30-31). The most effective of these programs have involved tax credits, which have been employed by the federal government and at least thirty-two states, including Ohio, to make ethanol economically viable. (Findings 11, 13, New Energy Finding 11, J.A. 25-26, 30-31).

The undisputed evidence at trial indicated that these credits are, for all practical purposes, responsible for the present existence of substantial interstate commerce in ethanol. The evidence showed, in fact, that without federal and state tax incentives, the existing interstate market for ethanol would not survive. New Energy's chief executive officer was asked, "With this difference in cost [between gasoline and ethanol] then, would you explain to the court how you would remain

competitive and induce a consumer to purchase ethanol or ethanol blends rather than regular gasoline?" He responded:

The only way we can currently do so is through the state and federal incentives or credits that exist, and *absent those credits . . . ethanol would not be a viable factor in the market place today.*

(J.A. 65, emphasis added). He further explained the applicability of this general principle to the Ohio ethanol tax credit and, in so doing, made clear that gasohol could not compete effectively with gasoline in Ohio without that credit. (J.A. 73-76, 147-149).<sup>2</sup> If there were no Ohio credit, Ohio fuel dealers would purchase gasoline instead of gasohol, and the allegedly burdened commerce in ethanol would dry up.

Belatedly recognizing what it had admitted by this evidence, New Energy has improperly presented to this Court a number of alleged "facts" that were not part of the record below concerning the existence of an ethanol market in states that provide no tax incentives.<sup>3</sup> In referring to these materials, New Energy apparently seeks to retract its contention throughout this case that

<sup>2</sup> As New Energy concedes, "[w]ithout the Ohio credit, the equivalent wholesale price of gasohol is a half cent more than gasoline. At this price, *ethanol is unattractive to the dealer . . .*" (Brief for Appellant at 6 n.2, emphasis added).

<sup>3</sup> The so-called "evidence" which New Energy supports by reference to the following sources was not presented to the trial court: *Alcohol Update* (Jan. 26, 1987), (Mar. 9, 1987), (Dec. 21, 1987) (cited in Brief for Appellant at 7, 8, 20, 21); Vaughn, Testimony before House Subcommittee on Energy and Power (June 24, 1987) (cited in Brief for Appellant at 8); Siegel, Carr, Gelb & Mielke, *Analysis of Possible Effects of H.R. 2052, Legislation Mandating the Use of Ethanol in Gasoline* (Oct. 13, 1987) (cited in Brief for Appellant at 5); and U.S. Motor Fuel Legislative and Regulatory Service (1987) (cited in Brief for Appellant at 8, 21).

"ethanol would not be a viable factor in the market place today" absent federal and state tax incentives. (J.A. 65). This information is not only improperly before the Court, but also is wholly inadequate to rebut New Energy's evidence at trial that the existence of an ethanol market, and indeed New Energy's own ability to market ethanol, depends upon federal and state incentives.<sup>4</sup>

## B. The Ohio Legislation And Its Impact

Along with the federal government and many other states, Ohio has recognized the benefits of ethanol use and has provided tax incentives to subsidize the sale of ethanol. (Findings 11, 13, New Energy Finding 11, J.A. 25-27, 30-31). Although it could have chosen (as did New Energy's state, Indiana) to encourage the in-state production of ethanol by directly subsidizing only Ohio ethanol producers, Ohio's General Assembly was willing indirectly to subsidize both in-state and out-of-state producers. This litigation arose because Ohio's willingness to subsidize out-of-state producers has not been completely unlimited; that willingness has instead been conditioned on the availability in those producers' states of a similar indirect subsidy for ethanol produced in

<sup>4</sup> The fact that incentives are necessary to the economical marketing of ethanol is supported by the findings of the United States Department of Agriculture and the General Accounting Office, as well as the undisputed testimony of New Energy's chief executive officer. See U.S. Department of Agriculture, *Ethanol: Economic and Policy Tradeoffs* 2 (Jan. 1988) ("The fuel-ethanol industry was created by a mix of Federal and State subsidies, loan programs and incentives. It continues to depend on Federal and State subsidies."); Report of the U.S. General Accounting Office, *Importance and Impact of Federal Alcohol Fuel Tax Incentives* 8 (June 6, 1984) (There was essentially no domestic ethanol before incentives were enacted and without incentives "there would not be a domestic fuel ethanol industry today.").

Ohio, a limit which was intended, among other things, to encourage other states to enact ethanol tax credits and which is fully consistent with the goal of stimulating ethanol production and use on a national basis. (New Energy Finding 21, State Finding 1, J.A. 31, 44).<sup>5</sup>

The Ohio ethanol credit is tied to a fuel tax that Ohio imposes on retail dealers for each gallon of gasoline sold in the state, Ohio Rev. Code Ann. § 5735.01 *et seq.* (Baldwin 1988). Under § 5735.145, fuel dealers are granted a credit toward this tax of 2.5¢ per gallon for the sale of gasoline that is blended with not more than ten percent ethanol. This credit is available for gasoline blended with ethanol produced in Ohio or any other state, unless the state of origin does not grant "an exemption, credit or refund from such state's motor vehicle fuel excise tax or sales tax for similar fuel containing ethanol produced in Ohio. . . ." Ohio Rev. Code Ann. § 5735.145(B) (Baldwin 1988).

Ethanol produced in numerous other states is eligible for Ohio's special incentive, and much ethanol produced outside of Ohio is available to Ohio retailers. (Finding 17, J.A. 28). The only ethanol producer with an Ohio production facility is appellee South Point Ethanol ("South Point"). Out-of-state producers who sell to Ohio dealers include Archer Daniels Midland ("ADM"), Pekin Energy ("Pekin"), and A.E. Staley ("Staley"). (*Id.*). ADM, the largest domestic producer of ethanol, and Pekin have production facilities in Illinois, and Staley has production facilities in Tennessee.

<sup>5</sup> New Energy states that the trial court failed to adopt a proposed finding that one of the purposes of § 5735.145(B) was "to provide a cleaner and safer environment for Ohio citizens by encouraging the use of ethanol as a replacement for lead gasoline not only in Ohio but in all states." (State Finding 1, J.A. 41). Brief for Appellant at 13. The trial court *did*, however, adopt this finding of fact. (J.S.A. 56a).

Ohio dealers selling gasoline blended with ethanol produced by ADM, Pekin, or Staley in Illinois or Tennessee, as well as with ethanol produced by South Point, are entitled to Ohio's ethanol tax credit. (*Id.*).

Ethanol produced in Indiana by New Energy, however, no longer qualifies for the Ohio tax incentive because Indiana decided in 1984 to limit its support of ethanol production to in-state producers. In implementing this decision, Indiana eliminated its ethanol tax credit, which was available for ethanol produced in other states as well as in Indiana, and replaced it with a direct subsidy available only to Indiana ethanol producers — of which New Energy was the only one. (J.A. 105-106).<sup>6</sup> As a result, Ohio fuel dealers who sell gasoline blended with ethanol produced by New Energy do not receive Ohio's ethanol tax credit.

The unavailability of the Ohio credit, the trial court found, will cause severe financial hardship to New Energy. (Finding 20, New Energy Finding 20, J.A. 29, 31). Section 5735.145(B) does not, however, preclude New Energy from selling ethanol in Ohio if it can do so economically without a financial subsidy from Ohio. (Finding 18, J.A. 28).

There was no evidence or a finding that the flow of interstate commerce would be adversely affected if the Ohio credit is denied to New Energy. On the contrary,

<sup>6</sup> Before New Energy began to compete in the Indiana ethanol market, Indiana encouraged the use of ethanol by applying a lower tax rate to all retail sales of gasoline than the rate for retail gasoline sales. In March 1984, in anticipation of New Energy's entry into the market, the Indiana legislature repealed the lower tax rate for ethanol, effective July 1, 1985, and replaced this lower tax rate with the Ethanol Fuel Production Incentive Grant, which in effect provided a direct subsidy available only to New Energy. (J.A. 68-69, 104-105). Following the trial in this case, Indiana law was amended to retain only 1¢ per gallon of gasoline subsidy. These grants have since been discontinued in Indiana.

the trial court found that ethanol producers from states other than Ohio, which are eligible for Ohio's incentive, can supply the portion of the Ohio ethanol market that New Energy supplied before § 5735.145(B) was enacted. (Finding 17, J.A. 28). Although the challenged statute may reduce New Energy's market share for ethanol in Ohio, New Energy presented no evidence that the statute was protectionist in its purpose or effect or that it would in any way affect the mix of in-state and out-of-state ethanol sold in Ohio or reduce the flow of ethanol into Ohio from other states.<sup>7</sup>

The evidence showed that rather than reducing the flow of ethanol sold in interstate commerce, the Ohio statute — along with similar federal and state incentives — actually increases interstate commerce in ethanol. By conditioning the provision of its credit on the availability of a like incentive for ethanol produced in Ohio, Ohio has encouraged the continued expansion of such interstate commerce.

### SUMMARY OF ARGUMENT

New Energy's attack on the reciprocity provision of § 5735.145(B) wholly ignores the manner in which the challenged provision operates and relies instead on a hodge-podge of general principles applied with little or no analysis. In essence, New Energy relies on no more than the erroneous assumption that reciprocity provisions are invalid per se, regardless of their impact, or lack of impact, on interstate commerce. That assumption cannot withstand scrutiny, and New Energy's proof at trial provided no alternative basis for invalidating § 5735.145(B).

<sup>7</sup> New Energy's evidence at trial, in fact, supported precisely the opposite conclusion. (J.A. 79-80).

To the extent that Ohio's unwillingness to subsidize New Energy's ethanol production makes it uneconomical for New Energy to sell its ethanol in Ohio, no impermissible burden is imposed on interstate commerce. The record in this case demonstrates that the allegedly burdened commerce is commerce that would not exist without the Ohio incentive, not commerce that arises naturally in response to private market forces. Ohio's incentive may not be as broad as New Energy would like, but, in light of the nature of the ethanol market, the challenged statute is not "the kind of action with which the Commerce Clause is concerned." *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 805 (1976).

The dependence of the Ohio ethanol market on the Ohio incentive also distinguishes this case from the reciprocity decisions on which New Energy relies. Unlike the reciprocity provisions in those cases, the Ohio incentive does not prevent or reduce the flow of interstate commerce. Instead, the statute encourages the flow of interstate commerce in ethanol.

New Energy has been unable to prove that § 5735.145(B) has either a protectionist purpose or effect. The record shows, and the trial court found, that the Ohio credit has the purpose of encouraging the production and use of ethanol. (Finding 11, New Energy Finding 11, J.A. 25-26, 30-31). The reciprocity provision enables Ohio to promote the advancement of this purpose not only in Ohio but in other states as well.

Finally, New Energy adduced no evidence at trial that § 5735.145(B) imposes any burden on interstate commerce. The record reveals that numerous out-of-state producers are active in the Ohio market, eligible for the Ohio incentive, and able to fill any gaps in the market which might result from a withdrawal by New Energy. To the extent that the statute is subjected to

Commerce Clause scrutiny, therefore, it clearly passes muster.

## ARGUMENT

### I. The Commerce Allegedly Burdened By Ohio Rev. Code § 5735.145(B) Depends For Its Existence On The Challenged Incentive. \*

New Energy does not contend that Ohio has created a *barrier* to interstate commerce in ethanol. Its argument is that the Commerce Clause has been violated because the *incentive* to such commerce embodied in Ohio's ethanol tax credit has not been extended to ethanol produced by New Energy in Indiana. Nothing in this Court's Commerce Clause jurisprudence supports this result.

Ohio's ethanol incentive program does not represent an attempt by the state to "place itself in a position of economic isolation," and the program has not placed "an unreasonable clog upon the mobility of commerce." *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 527 (1935).<sup>5</sup> The incentive program imposes no prohibitions on the interstate movement of ethanol. In fact, the Ohio incentive promotes interstate commerce; it is undisputed that the incentive has increased the amount of ethanol placed in interstate commerce and that its elimination would significantly lessen the volume of interstate commerce in ethanol. (J.A. 65). Indeed, this positive effect on the volume of commerce in ethanol was a principal aim of the legislation.

As a result, New Energy's discussion of the effect of § 5735.145(B) and whether or not any adverse effect entitles New Energy to relief under the Commerce

<sup>5</sup> See Brief for Appellant at 21-22, *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794 (1976).

Clause is unpersuasive. It amounts to a claim that New Energy is *entitled* to receive Ohio's aid. New Energy's argument implicitly assumes that the company had some sort of constitutional right to receive aid from Ohio, and that any injury caused by a limitation placed on the availability of the credit is one for which the Commerce Clause provides a remedy.

For Commerce Clause purposes, this cannot be the correct method of analyzing the impact of § 5735.145(B). Neither New Energy nor any other ethanol producer, whether located in Ohio or elsewhere, has a constitutional right to receive supportive subsidies or incentives. At best, New Energy is only entitled to reap whatever benefit it can derive from the natural functioning of the free marketplace. The question whether § 5735.145(B) has a constitutionally cognizable impact by disrupting the natural market position to which New Energy has a right can be resolved only by comparing New Energy's position after enactment of the section to the position it would enjoy if Ohio provided *no* ethanol tax credit. When this comparison is made, the only conclusion supported by the record is that § 5735.145(B) does not put New Energy in a position any worse than the one in which it would find itself in the absence of any Ohio ethanol tax credit.<sup>9</sup>

New Energy's chief executive officer testified that his company would be unable to market ethanol profitably in Ohio without the Ohio tax credit, because the price it would receive would be too low in relation to production costs. (J.A. 63-65, 71-77, 147-149). This evidence translates directly into a conclusion that without the Ohio incentive there would be *no* commerce for

<sup>9</sup> New Energy may well have been in a better position before the enactment of § 5735.145(B), but it enjoyed that position as a result of Ohio's generosity and not as a matter of right.

New Energy in ethanol in Ohio.<sup>10</sup> New Energy, this evidence makes clear, is "not in the position of a foreign business which enters a State in response to completely private market forces to compete with domestic businesses, only to find itself burdened with discriminatory taxes or regulations." *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 810 n.20 (1976). New Energy is instead confronted with the reality that the economics of its business are such that, given the operation of private market forces, its product, ethanol, costs more to produce than New Energy can charge and still compete effectively with the alternative product, gasoline, that ethanol is intended to replace.

The fact that Ohio provides an incentive to obviate this reality for ethanol produced in Ohio and numerous other states, but no longer does so for ethanol produced by New Energy in Indiana, because Indiana provides no similar incentive for ethanol produced in Ohio, does not trigger Commerce Clause concerns. The Commerce Clause rests on the premise that "this Nation is a common market in which state lines cannot be made barriers to the free flow of both raw materials and finished goods in response to the economic laws of supply and demand." *Alexandria Scrap*, 426 U.S. at 803 (emphasis added). "The common thread in all these [Commerce Clause] cases is that the State interfered with the natural functioning of the interstate market either through prohibition or through burdensome regulation." *Id.* at 806 (emphasis added). Where the affected commerce does not result from "the natural functioning

<sup>10</sup> New Energy has in effect conceded that the Ohio incentive is essential to the existence of an Ohio market for New Energy's ethanol by not challenging the credit itself. New Energy has instead only challenged the reciprocity provision of the Ohio incentive program which allocates the credit among the various ethanol producers.

of the interstate market" but rather is "created, in whole or substantial part," by the challenged state statute, *id.* at 809 n.18, the statute does not give rise to "a burden which the Commerce Clause was intended to make suspect." *Id.* at 807.

This case squarely presents the question alluded to in the majority and concurring opinions in *Alexandria Scrap*, which rejected a Commerce Clause challenge to a Maryland statute offering a state bounty on inoperable automobile hulks.<sup>11</sup> The Maryland statute had the effect of disadvantaging all out-of-state scrap processors in relation to in-state processors. Although the case was decided on the ground that the state was acting as a market participant, Justice Powell observed in his majority opinion, in language directly applicable to the Ohio ethanol incentive,

that the commerce affected by the 1974 amendment appears to have been created, in whole or in substantial part, by the Maryland bounty scheme. We would hesitate to hold that the Commerce Clause forbids state action reducing or eliminating a flow of commerce dependent for its existence upon state subsidy instead of private market forces.

426 U.S. at 809 n.18 (emphasis added).

Justice Stevens' concurring opinion in *Alexandria Scrap* explained this concept more fully:

It is important to differentiate between commerce which flourishes in a free market and commerce which owes its existence to a state subsidy program. Our cases finding that a state regulation constitutes an impermissible

<sup>11</sup> The issue was not "clearly presented" in *Alexandria Scrap* "[b]ecause the record contain[ed] no details of the hulk market prior to the bounty scheme. . . ." 426 U.S. at 809 n.18. See also *Reeves, Inc. v. Stake*, 447 U.S. 429, 446 n.18 (1980).

burden on interstate commerce *all dealt with restrictions that adversely affected the operation of a free market*. This case is unique because the commerce which Maryland has "burdened" is commerce which would not exist if Maryland had not decided to subsidize a portion of the automobile scrap-processing business.

*Id.* at 815 (emphasis added);<sup>12</sup> see also Regan, *The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause*, 84 Mich. L. Rev. 1091, 1196 nn. 202, 203 (1986).

Justice Stevens was surely correct in observing that the many cases invalidating state regulation under the Commerce Clause, including those on which New Energy relies here, "all dealt with restrictions that adversely affected the operation of a free market." 426 U.S. at 815; see also *id.* at 806 (majority opinion). Invalidating of § 5735.145(B) would require a broad and unwarranted extension of the principles underlying those cases. As the Court expressly recognized in *Alexandria Scrap*, it is one thing to say that interstate commerce is burdened when a state imposes a discriminatory tax on a foreign business whose participation in the state's economy is motivated by the competitive forces of the free market, but quite another to say that interstate commerce is burdened by a state's rational failure to extend to all foreign businesses a subsidy for a product that is too costly to attract customers in a free market. *Id.* at 810 n.20.

<sup>12</sup> Justice Stevens noted that the result would not differ had the market been merely small rather than nonexistent before the bounty scheme was enacted: "[T]he analysis is the same whether we are dealing with the newly created portion of a pre-existing market or with an entirely new market." *Alexandria Scrap*, 426 U.S. at 815.

Viewed in this way, § 5735.145(B) does not impose any impermissible burden on interstate commerce. Ohio has created a tax incentive — applicable to both in-state and out-of-state ethanol — to encourage the production and use of ethanol. By so doing, Ohio has given rise to commerce that would not exist without the incentive. Just as Ohio could not be criticized under the Commerce Clause for failing to create that commerce in the first instance, the state cannot be said to have burdened interstate commerce by limiting the availability of its incentive in order to induce other states to create similar incentives. *Alexandria Scrap*, 426 U.S. at 815-817 (Stevens, J., concurring).<sup>13</sup> In such circumstances, where the state has no obligation to create the market or to subsidize out-of-state businesses, "[w]hether the encouragement takes the form of a cash subsidy, a tax credit, or a special privilege intended to attract investment capital, it should not be characterized as a 'burden' on interstate commerce." *Id.* at 816 (Stevens, J., concurring). The "burden" caused by nonreceipt of the benefit of § 5735.145(B) is not "the kind of action with which the Commerce Clause is concerned." *Alexandria Scrap*, 426 U.S. at 805.

<sup>13</sup> [T]here must have been countless situations during the past two centuries in which the several States have experimented with different methods of encouraging local enterprise without providing like encouragement to out-of-state competitors. The absence of any previous challenge to such programs reflects, I believe, a common and correct interpretation of the Commerce Clause as primarily intended (at least when Congress has not spoken) to inhibit the several States' power to create restrictions on the free flow of goods within the national market, *rather than to provide the basis for questioning a State's right to experiment with different incentives to business*.

*Id.* at 817 (emphasis added).

## II. The Statutory Limit On Ohio's Willingness To Subsidize The Growth And Development Of Interstate Commerce In Ethanol Is Fully Consistent With This Court's Reciprocity Decisions.

One of the purposes supporting the enactment of § 5735.145(B) was the promotion of industry generally by influencing other states to enact similar incentives to encourage the use of ethanol. (J.S.A. 63a). New Energy decries this purpose, relying heavily on *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511 (1935), *Brown-Forman Distillers Corp. v. New York State Liquor Authority*, 106 S. Ct. 2080 (1986), and two decisions invalidating state statutes with so-called reciprocity provisions, *Great Atlantic & Pacific Tea Co. v. Cottrell*, 424 U.S. 366 (1976) ("A&P"), and *Sporhase v. Nebraska ex rel. Douglas*, 458 U.S. 941 (1982). None of these cases calls into question the validity of § 5735.145(B).

As an initial matter, neither *Baldwin* nor *Brown-Forman* involved an inducement by one state to affect another state's legislative policy. Both cases involved statutes that regulated the primary conduct of foreign businesses in transactions occurring entirely outside the state. Moreover, both cases involved regulation of commerce generated by completely private market forces.

In *Brown-Forman*, for example, a New York law prohibited the wholesale sale of liquor at prices any higher than the lowest price the seller would charge for its product elsewhere in the United States during the same month. The statute was challenged by a distiller who was forced by the statute to discontinue out-of-state promotional programs by which the distiller offered special cash discounts to retailers to use for advertising purposes. The New York statute effectively regulated the price at which the distiller could sell its product in other states, and the Court held that New York's attempt to "project its legislation into [other

States] by regulating the price to be paid for liquor in those States" violated the Commerce Clause, 106 S. Ct. at 2086 (quoting *Baldwin*, 294 U.S. at 521). Section 5735.145(B), in contrast, only affects transactions in Ohio. It has no effect on what New Energy is allowed to do in Indiana or in any other state. To be sure, the impact of the statute on New Energy's effort to sell ethanol in Ohio may be designed to influence the conduct of the Indiana legislature, but that is not a topic that the Court addressed in *Brown-Forman*; it clearly is not something that the Court in any way suggested was unconstitutional.<sup>14</sup>

*Baldwin* has even less bearing on this case. At issue there was the validity of the New York Milk Control Act, which prohibited in-state sales of milk bought outside of New York unless the price to the out-of-state producer was no lower than the minimum price payable to New York producers. The avowed purpose of the Act was to increase milk prices in order to protect New York producers from out-of-state competition — "a classic illustration of economic provincialism." *Brown-Forman*, 106 S. Ct. at 2090 (Stevens, J., dissenting). As it did over fifty years later in *Brown-Forman*, the Court in *Baldwin* held that New York's indirect regulation of prices paid

<sup>14</sup> The *Brown-Forman* Court did mention possible alterations of other state's regulatory schemes, 106 S. Ct. at 2087. This language, however, must be read in context. What the *Brown-Forman* Court was concerned about, and what this case does not involve, was an attempt to regulate transactions occurring wholly outside of the state. The type of promotional scheme which appellant in *Brown-Forman* had in mind was legal in many other states, but could not be accomplished in those states if appellant complied with New York law. While the other states could alter their laws to permit appellant to do what it wanted while still complying with New York law, the object of the New York statute was not to encourage them to do so, and the effect of the statute was to regulate transactions in other states.

in other states to producers located in those states unduly burdened interstate commerce. 294 U.S. at 524. That holding has no more impact on the validity of Ohio's purpose in enacting § 5735.145(B) than does the later *Brown-Forman* decision.

Although they were decided under the Equal Protection Clause, the Court's recent decisions in *Metropolitan Life Insurance Co. v. Ward*, 470 U.S. 869 (1985), and *Western & Southern Life Insurance Co. v. State Board of Equalization*, 451 U.S. 648 (1981), shed far more light on this case than do *Baldwin* and *Brown-Forman*. Both *Ward* and *Western & Southern* involved discriminatory state taxes imposed on out-of-state insurance companies, and together they stand for the proposition that promoting the *in-state* business of domestic companies by penalizing foreign companies who also want to do business in the state is not a legitimate state purpose, but that promoting the *interstate* business of domestic companies by deterring other states from enacting discriminatory or excessive taxes is a legitimate state purpose. *Ward*, 470 U.S. at 876-78; *Western & Southern*, 451 U.S. at 671.

Ohio's ethanol incentive is designed to encourage the use of ethanol in Ohio and thus to spur its production in Ohio and elsewhere. It applies to both foreign and domestic ethanol, and is not intended to provide an advantage to Ohio ethanol producers at the expense of foreign ethanol producers who compete for the business of Ohio fuel dealers. There was no finding that the reciprocity limitation was intended to increase, or that it did increase, any Ohio producer's share of the *Ohio ethanol market*. Instead, the provision encourages other states to provide similar incentives, one effect of which is to enable Ohio ethanol producers — and quite probably a number of out-of-state producers — to market their product *in other states*.

As the Court noted in *Western & Southern*, citing two Commerce Clause decisions: "There can be no doubt that promotion of domestic industry by deterring barriers to interstate business is a legitimate state purpose." 451 U.S. at 671 (citing *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970), and *Parker v. Brown*, 317 U.S. 341 (1943)). In other words, a state's promotion of local industry may be a valid purpose under the Commerce Clause if that purpose serves national rather than merely local interests. *Ward*, 470 U.S. at 876 n. 6. Ohio's statute has just such a valid purpose. By encouraging other states to enact similar incentives for ethanol production and use, § 5735.145(B) deters barriers to interstate trade in ethanol. Although the interests of local producers are served by the statute, numerous out-of-state producers are also benefited and the end goal — an open and substantial national market for ethanol — strongly serves national interests.

New Energy speaks in sweeping and general terms of Ohio's "discrimination" against business from other states, but fails to identify any barrier to interstate commerce created by the statute. The reason for this absence of proof is clear: the challenged statute imposes no such barrier and does not prevent the movement of ethanol in interstate commerce. As previously discussed in detail, the Ohio incentive is essential to the existence of the commerce that it allegedly burdens. Ohio's refusal to extend the credit to ethanol produced in Indiana unless Indiana provides a similar credit for ethanol produced in Ohio thus does not interfere with "the natural functioning of the interstate market." *Alexandria Scrap*, 426 U.S. at 806.

This fact clearly distinguishes the reciprocity decisions on which New Energy relies. In *A&P*, for example, Mississippi banned the sale of all out-of-state milk unless the producer state accepted Grade A milk from Missis-

ssippi.<sup>15</sup> In striking down this reciprocity clause, the Court found that it had a "devastating effect upon the free flow of interstate milk," 424 U.S. at 375, and did not serve any legitimate interest of the state. Similarly, in *Sporhase*, Nebraska banned the withdrawal of ground water intended for use in any adjoining state unless that state granted reciprocal rights for the use of its water in Nebraska. This reciprocity provision, which did not significantly advance any legitimate state interest, 458 U.S. at 958, "operate[d] as an explicit barrier to commerce between" Nebraska and Colorado, *id.* at 957, and prevented commerce in water that otherwise would have occurred.

This case presents facts quite different from those in *A&P* and *Sporhase*.<sup>16</sup> In each of those cases, the challenged reciprocity provisions burdened interstate commerce by preventing or drastically reducing the flow of goods across state lines. In light of New Energy's admission that it would be unable to sell ethanol in Ohio without the Ohio incentive, the same cannot be said here. Because it provides a tax incentive to all out-of-state ethanol except ethanol from states lacking similar incentives, the Ohio statute is a narrowly tailored means of *encouraging* interstate commerce in ethanol among all the states. The statute invites cooperation, not retaliation, from other states, in an attempt to promote a broad

<sup>15</sup> But for this reciprocity clause, a Louisiana producer was ready, willing, and able to supply wholesome milk to Mississippi; the only thing that prevented it from doing so was Mississippi's refusal to permit such sales. 424 U.S. at 369-70.

<sup>16</sup> Another contrast between § 5735.145(B) and the statutes in *A&P* and *Sporhase* is that the Ohio statute does not absolutely ban the sale of out-of-state ethanol; it merely denies a partial tax credit to the dealers who purchase such ethanol.

interstate market for ethanol.<sup>17</sup> In no sense can Ohio be said to have "threaten[ed] complete isolation as the

<sup>17</sup> Unlike the reciprocity provisions struck down in *A&P* and *Sporhase*, § 5735.145(B) does not "invite a multiplication of preferential trade areas destructive of the very purpose of the Commerce Clause." *A&P*, 424 U.S. at 380 (quoting *Dean Milk Co. v. Madison*, 340 U.S. 349, 356 (1951)). In fact, in the peculiar context of the government-subsidized ethanol market, such balkanization of the market is more likely to be created by statutes that provide incentives for ethanol use and production but do *not* contain a reciprocity provision. Such statutes create markets for ethanol use and production only in the enacting states. Reciprocity provisions like Ohio's are better suited to encouraging *all* states to open their markets to both in-state and out-of-state ethanol.

The reciprocity provision of the Ohio statute prevents it from violating the "internal consistency" test that this Court has recently applied in analyzing certain state tax laws. The Ohio tax is such that, "if applied by every jurisdiction," there would be no impermissible interference with free trade." *Armco, Inc. v. Hardesty*, 467 U.S. 638, 644 (1984) (quoting *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, (1983)); see also *Tyler Pipe Indus., Inc. v. Washington Dept. of Rev.*, 107 S. Ct. 2810 (1987). On the contrary, the adoption by every state of "the precise scheme here," *Armco*, 467 U.S. at 644, would not interfere with free trade but would instead be the very means by which interstate trade in ethanol could flourish. New Energy loosely interprets the internal consistency test as allowing an analysis of the Ohio statute which assumes that other states adopt reciprocity provisions similar to Ohio's in granting a credit but differing in the amount of credit offered. Brief for Appellant at 27 n.9. This Court has never applied the test in this manner, but has instead analyzed the impact of every state's adoption of an *identical* statute, which includes identical tax rates. See *Armco*, 467 U.S. at 644.

In any event, the applicability of the internal consistency test to § 5735.145(B) is doubtful. In the cases establishing and applying that test, the Court was concerned with preserving free trade among the states in the face of state laws imposing heavier tax burdens on nonresident taxpayers than resident taxpayers. See *Tyler Pipe*; *American Trucking Assn., Inc. v. Scheiner*, 107 S. Ct. 2829 (1987). Unlike the nonresident taxpayers in those cases, New

alternative to acceptance of its offer of reciprocity" or "use[d] the threat of economic isolation as a weapon to force sister States into even a desirable reciprocity agreement." *A&P*, 424 U.S. at 379. Ethanol from Indiana is not barred from the Ohio market, and New Energy is free to sell in Ohio if such sales are warranted by private market forces. The contrast between the absolute prohibition in *A&P* and the withholding of an incentive here is clear, for the only "economic isolation" that results here is that very isolation that would exist if Ohio had done nothing at all.

Invalidation of § 5735.145(B) would require a conclusion that the Commerce Clause prohibits a state that has decided to use its laws to make economically viable a product for which there would otherwise be no market from structuring its incentive in such a way as to encourage other states to provide similar incentives, thus opening up a national market for the product. There is no basis for such a result.

### III. Ohio Rev. Code § 5735.145(B) Has Neither The Purpose Nor The Effect of Protecting Local Producers At The Expense Of Interstate Commerce.

The Ohio Supreme Court correctly focused on the ultimate issue in this case: whether the statute had as its purpose or effect economic protectionism. This Court has consistently prohibited states from favoring local producers at the expense of interstate commerce. See, e.g., *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984);

Energy is "not in the position of a foreign business which enters a State in response to completely *private* market forces to compete with domestic businesses, only to find itself burdened with discriminatory taxes or regulations." *Alexandria Scrap*, 426 U.S. at 810 n.20 (emphasis added). Instead, § 5735.145(B) encourages the opening of an interstate market for all ethanol producers, including New Energy.

*Hunt v. Washington State Apple Advertising Commission*, 432 U.S. 333 (1977); see generally *Regan, supra*. As the Supreme Court of Ohio properly found, however, § 5735.145(B) is not protectionist in either its purpose or effect. *New Energy Co. v. Limbach*, 32 Ohio St. 3d 206, 207, 513 N.E.2d 258, 259 (1987) (J.S.A. 4a).

If the Ohio legislature had wanted to protect Ohio ethanol producers from out-of-state competition, § 5735.145(B) was a highly impractical means to achieve that end. It would have been much more effective to directly subsidize only in-state producers, as Indiana did, or to subsidize them indirectly by limiting the Ohio incentive to ethanol produced in Ohio. Ohio instead enacted an incentive that applied not only to in-state producers but also to producers from numerous other states, including Illinois, home of the nation's largest ethanol producer. The Ohio legislation did nothing to insulate Ohio producers from competition with producers from these states. On the contrary, the statute encourages such out-of-state producers to enter the Ohio market.

The presence of this vigorous interstate competition for Ohio business contrasts sharply with the situation in the cases cited by New Energy. For its argument that the Ohio statute unconstitutionally discriminates against out-of-state businesses, New Energy relies upon *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318 (1977), and *Bacchus Imports*. In both of these cases, the statute at issue treated out-of-state competitors differently from local competitors in order to confer on the "home team" economic advantages unavailable to any outsider.

For example, in *Boston Stock Exchange* the state taxed all out-of-state stock transfers but no in-state transactions. As a result, in-state stock exchanges were totally insulated from competition with out-of-state

firms. This complete protection from out-of-state competition was the determinative factor in the Court's decision:

[T]he fundamental principle that we find dispositive of the case now before us [is]: No State may, consistent with the Commerce Clause, "impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business."

429 U.S. at 329; see also *Bacchus Imports*, 468 U.S. at 271-272.

This dispositive factor of protectionism is totally absent in this case. Section 5735.145(B) does not give the "home team" any advantage at the expense of all "outsiders." See *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117 (1978) (no unconstitutional discrimination in the absence of a protectionist purpose, although virtually all those advantaged by the statute were "insiders" and those disadvantaged were "outsiders"). The Ohio statute does not discriminate against interstate commerce to protect a domestic producer.<sup>15</sup>

The facts adduced at trial show that all interstate competitors in the Ohio market, except New Energy, received the Ohio credit. (Finding 17, J.A. 28). Further, it is undisputed that these interstate competitors were ready, willing, and able to supply New Energy's portion of the Ohio ethanol market, if New Energy withdrew from this market. (*Id.*). New Energy attempts to combat this evidence with the novel argument that "there is no reason not to think" that the Ohio statute may have

<sup>15</sup> The number of states and national organizations that have recognized that § 5735.145(B) is not a protectionist attempt to favor Ohio producers at the expense of interstate commerce and have filed *amicus* briefs supporting appellees' position is striking confirmation of this conclusion.

increased South Point's market share in Ohio, rather than the market share of its out-of-state competitors. Brief for Appellant at 24. But New Energy, as challenger to the Ohio statute, has the burden of proving that the statute is unconstitutionally discriminatory. See, e.g., *Hughes v. Oklahoma*, 441 U.S. 322, 336 (1979). New Energy cannot escape its failure to prove any discrimination against interstate commerce by simply assuming that such discrimination exists.

New Energy attempts to obscure its failure of proof by speculating that the legislature must have had a protectionist motive, based on certain technical definitions in the statute. New Energy claims that if Ohio's purpose were truly to encourage the use of ethanol, it would have allowed a credit for ethanol from every state, no matter whether or not such states promoted ethanol use or by what means they did so. Brief for Appellant at 33-34. But if Ohio had not restricted its credit to ethanol produced in states with similar incentives, the statute would be unable to fulfill the legislative goal of encouraging other states to enact such incentives and thus creating an interstate market for ethanol. New Energy also claims that Ohio's purpose could not really be "serious," or else the statute would not define ethanol as being produced either (1) in a manufacturing facility with a capacity of less than two million gallons and from wood or the grain of a cereal grass or (2) from a coal-fired process from wood or the grain of a cereal grass. *Id.* at 34. New Energy has never claimed that this definition of ethanol restricts any producer, not even itself, from being eligible for the Ohio incentive. In fact, New Energy's own proof at trial establishes that almost all United States ethanol is produced from corn (the grain of a cereal grass) and that the producer with the highest production capacity in the country is eligible for the Ohio credit. (J.A. 56, 77,

135). New Energy failed to prove that the Ohio legislature had any protectionist purpose for enacting § 5735.145(B).

Having failed to prove any protectionist purpose, New Energy next interprets the record quite generously in an attempt to imply that Ohio enacted § 5735.145(B) to retaliate against Indiana for taking its ethanol tax credit away from South Point. Brief for Appellant at 31. The record is devoid of evidence of any such retaliatory purpose. New Energy can only point to the testimony of its own chief executive officer concerning *his* belief that South Point lobbied for passage of the statute to put pressure on Indiana to enact an ethanol tax credit. Brief for Appellant at 31 (quoting J.A. 123).

The testimony of South Point's general manager only verifies that South Point sought "an incentive to *all states* to enact all legislation that would promote the sale of ethanol in their states." (J.A. 139 (emphasis added)). This purpose coincides with the trial court's finding of legislative purpose. (J.S.A. 63a). As previously discussed, such a purpose is valid because the reciprocity provision was not designed to promote the in-state business of Ohio producers, but rather to enhance their ability to do business outside Ohio. Once again, New Energy has failed to satisfy its burden of proving that the Ohio statute is unconstitutionally discriminatory.

#### IV. New Energy Failed To Prove At Trial That Ohio Rev. Code § 5735.145(B) Imposes A Burden On Interstate Commerce.

At every level of appeal of this case, New Energy has been unable to surmount the barrier of its failure to prove — or even to present any evidence — at trial that the Ohio statute imposes a burden on interstate commerce. Instead, New Energy merely asserts that the reciprocity provision "discriminates" against interstate

commerce, and asks this Court to declare the statute unconstitutional without any supporting evidence. In fact, New Energy purposely created a situation where the courts could only speculate as to the existence of any burden that might result from the statute, by seeking trial on an expedited basis before the statute became effective rather than waiting to see what its actual impact would be. New Energy then asked the courts to ignore long-established principles of constitutional decision-making and to declare that the statute unconstitutionally burdens interstate commerce based purely upon speculation, rather than evidence.

This Court has traditionally applied two separate tests for measuring the states' compliance with the Commerce Clause:

where simple economic protectionism is effected by state legislation, a virtually per se rule of invalidity has been erected.

...

But where other legislative objectives are credibly advanced and there is no patent discrimination against interstate trade, the Court has adopted a much more flexible approach. . . .

*Philadelphia v. New Jersey*, 437 U.S. 617, 624 (1978). The "more flexible approach" was first articulated in *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970): when the statute "effectuate[s] a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits." The party challenging a statute under the Commerce Clause has the burden of establishing that the statute imposes a burden on interstate commerce. See, e.g., *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117 (1978).

New Energy asks the Court to reject the flexible *Pike* balancing test in favor of the "strictest scrutiny" represented by the "virtually per se rule", simply because the Ohio statute has a reciprocity provision. Brief for Appellant at 18. Rather than analyzing the statute using the "strictest scrutiny," however, New Energy simply argues that § 5735.145(B) is unconstitutional because it is "facially discriminatory." This Court has never rejected reciprocity provisions on this basis alone; to do so would be to apply an absolute per se rule because reciprocity provisions by their very nature distinguish based upon state lines.

Indeed, the Court has not generally applied the "virtually per se rule" to reciprocity provisions. See *A&P*; see also Smith, *State Discrimination Against Interstate Commerce*, 74 Cal. L. Rev. 1203, 1240-1241 (1986) (reciprocity statutes not necessarily discriminatory; they may have the purpose and effect of eliminating the difference in treatment between those inside and outside the state). To do so would be particularly inappropriate in this case where no "simple economic protectionism" has been proved and where the statute benefits numerous out-of-state ethanol producers to the same extent that it benefits Ohio producers.<sup>19</sup>

To warrant invalidation of § 5735.145(B) under the Commerce Clause, then, New Energy had the burden to prove — not hypothetically, but with substantive evidence — that (1) the provision imposes a burden on interstate commerce, and (2) the burden imposed clearly outweighs any legitimate state interest advanced

<sup>19</sup> Even under the "virtually per se rule", this Court has recognized that "[n]ot all intentional barriers to interstate trade are protectionist. . . ." *Maine v. Taylor*, 106 S. Ct. 2440, 2453 n.19 (1986). Because § 5735.145(B) was narrowly tailored to its legitimate purpose of expanding the interstate market for ethanol, the statute should survive even strict review.

in support of the statute. *Pike*, 397 U.S. at 142. The record below and the findings of the trial court establish that New Energy failed to meet its burden of proof on these issues.<sup>20</sup>

New Energy attempts to avoid this absence of proof by presenting self-serving statements made by one of its officers two and three years after trial concerning financial hardship allegedly suffered by New Energy. This "evidence" was not part of the record before the trial court and is therefore not properly before this Court.

Even if any information about the impact of the statute on New Energy's participation in the Ohio market were in the record, New Energy's effort to prove that the Ohio statute burdens interstate commerce focuses entirely on the impact of that statute on New Energy's own business. This Court has stated, however, that "[t]he fact that the burden of a state regulation falls on some interstate companies does not, by itself, establish a claim of discrimination against interstate commerce." *Exxon*, 437 U.S. at 126; see also *CTS Corp. v. Dynamics Corp. of America*, 107 S. Ct. 1637, 1649 (1987). The challenged statute in *Exxon* prohibited a producer or refiner of petroleum products from operating any retail service station within the state of Maryland. The plaintiff complained that the statute would require it to stop selling its product in Maryland. The Court concluded, however, that the plaintiff's withdrawal from the market would not warrant:

. . . a finding that the statute impermissibly burdens interstate commerce.

<sup>20</sup> Because New Energy failed to offer *any* evidence of a burden on interstate commerce, this Court need not analyze the extent of any such burden in relation to the purposes supporting the statute. See *Pike*, 397 U.S. at 142.

Some refiners may choose to withdraw entirely from the Maryland market, but there is no reason to assume that their share of the entire supply will not be promptly replaced by other interstate refiners. The source of the consumers' supply may switch from company-operated stations to independent dealers, but interstate commerce is not subject to an impermissible burden simply because an otherwise valid regulation causes some business to shift from one interstate supplier to another.

*Exxon*, 437 U.S. at 127. In other words, the Commerce Clause is concerned with the impact of a statute on the total flow of interstate commerce from all sources rather than the potential impact upon a single company. *Id.* at 126 n.16; *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 474 (1981).

This analysis of the Commerce Clause does not mean that a state may arbitrarily discriminate against a particular business. Instead, it recognizes that the protection of specific firms stems from the Equal Protection Clause, not the Commerce Clause. As this Court recently explained: "The two constitutional provisions perform different functions in the analysis of the permissible scope of a State's power — one protects interstate commerce, and the other protects persons from unconstitutional discrimination by the States." *Ward*, 470 U.S. at 881 (footnote omitted).

New Energy initially brought its claim under the Equal Protection Clause as well as the Commerce Clause. After this Court announced its decision in *Ward*, New Energy withdrew its Equal Protection claim. New Energy now attempts to base its Commerce Clause claim on evidence that goes, at best, to the Equal Protection question rather than to the issue of a burden upon interstate commerce taken as a whole.

New Energy presented no evidence of any burden on any other out-of-state ethanol producer or on the general flow of ethanol into Ohio from outside the state, other than its novel assertion that "there is no reason not to think" that the statute decreased the market share of out-of-state producers. Brief for Appellant at 24. The record shows, however, that a minimum of three out-of-state producers sell ethanol in Ohio, are eligible for the Ohio incentive, and have adequate capacity to replace the share of the market served by New Energy. (Finding 17, J.A. 28). Thus, the purported "competitive disadvantage" of which New Energy complains is not limited to a comparison with merely local producers, but includes several interstate competitors as well. Indeed, because the Ohio statute actually creates an interstate market that would not otherwise exist, it makes no sense to characterize the statute as creating the type of burden with which the Commerce Clause is concerned. See *Alexandria Scrap*, 426 U.S. at 805.

New Energy has not proved that the Ohio statute imposes *any* burden on interstate commerce, let alone a "clearly excessive" burden. See *Pike*, 397 U.S. at 142. The lower courts correctly applied the constitutional test mandated by this Court and held, as a result, that New Energy had failed to establish its claim challenging the constitutionality of § 5735.145(B).

### CONCLUSION

The courts below properly held that § 5735.145(B) was not enacted for purposes of economic protectionism, that the Ohio legislature had a legitimate purpose for enacting the statute and that New Energy failed to prove that the statute imposed a burden upon interstate commerce. For the foregoing reasons, the Court should affirm the judgment of the Supreme Court of Ohio declaring § 5735.145(B) to be constitutional.

Respectfully submitted,

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Supreme Court, U.S.

**FILED**

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**NEW ENERGY COMPANY OF INDIANA,**  
*Appellant,*

v.

**JOANNE LIMBACH  
TAX COMMISSIONER OF OHIO,  
MARY ELLEN WITHROW, TREASURER OF OHIO,  
AND SOUTH POINT ETHANOL,**  
*Appellees.*

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**ON APPEAL FROM  
THE SUPREME COURT OF OHIO**

**BRIEF OF APPELLEES JOANNE LIMBACH,  
TAX COMMISSIONER OF OHIO, AND  
MARY ELLEN WITHROW, TREASURER OF OHIO**

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## **QUESTIONS PRESENTED**

Whether Ohio Revised Code 5735.145(B) Which Restricts The Subsidy Provided By The Ohio Ethanol Tax Credit To Dealers Which Use Ethanol Produced In Ohio And In Any Other State Which Grant Similar Credits Violates The Commerce Clause.

I. Whether The Ohio Ethanol Tax Credit Scheme Imposes The Type Of Burden On Interstate Commerce Which The Commerce Clause Was Intended To Prohibit.

II. If Ohio Revised Code 5735.145(B) Is Subject To The Strictures Of The Commerce Clause, Is Any Incidental Burden On Interstate Commerce Clearly Outweighed By The Local Benefits To The Health And Safety Of The People Of Ohio Advanced By The Legislation.

A. Is Ohio Revised Code 5735.145(B) An "Economic Protectionist" Measure.

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No. 87-654

IN THE  
SUPREME COURT of the UNITED STATES

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October Term, 1987

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NEW ENERGY COMPANY OF INDIANA,  
*Appellant,*

v.

JOANNE LIMBACH, TAX COMMISSIONER OF  
OHIO,  
MARY ELLEN WITHROW, TREASURER OF OHIO,  
AND SOUTH POINT ETHANOL,  
*Appellees.*

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**ON APPEAL FROM  
THE SUPREME COURT OF OHIO**

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BRIEF OF APPELLEES JOANNE LIMBACH,  
TAX COMMISSIONER OF OHIO,  
AND MARY ELLEN WITHROW, TREASURER OF OHIO

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### STATEMENT OF THE CASE

New Energy challenges the constitutionality of Ohio Revised Code 5735.145(B) which was enacted as part of Amended Substitute Senate Bill No. 334, which became

effective on January 1, 1985. That provision reads as follows:

(B) The qualified fuel otherwise eligible for the qualified fuel credit shall not contain ethanol produced outside Ohio unless the Tax Commissioner determines that the fuel claimed to be eligible for credit contains ethanol produced in a state that also grants an exemption, credit or refund from such state's motor vehicle fuel excise tax or sales tax for similar fuel containing ethanol produced in Ohio; provided however, that such credit shall not exceed the amount of credit allowable for qualified fuel containing ethanol produced in Ohio.

New Energy argues that this reciprocity provision violates the Commerce Clause (Art. I, Sec. 8, cl. 3) of the United States Constitution.

The qualified fuel credit referred to in Ohio Revised Code 5735.145(B) is provided by Ohio Revised Code 5735.145(A) against the motor vehicle fuel tax imposed on motor vehicle fuel dealers. Such dealers are allowed a credit for each gallon of ethanol blended with gasoline in not more than a 10% ratio and used, sold or distributed by dealers in Ohio. The amount of the credit per gallon is based on a statutory formula and varies based upon changes in the federal gasohol credit. Ohio Revised Code 5735.145(A)(4). The motor vehicle fuel tax is imposed upon and the ethanol tax credit is available solely to motor vehicle fuel dealers, not ethanol producers.

The ethanol tax credit is available not only for Ohio-produced ethanol which is used to create gasohol. It is also available for ethanol produced in any other state which grants similar tax incentives for ethanol use. Ohio Revised Code 5735.145(B). In fact, at the time the complaint was filed and at the time the reciprocity provision was enacted ethanol produced by every out-

of-state producer which competes in the Ohio market, with the sole exception of New Energy, was eligible for the full Ohio tax credit. The evidence established that these out-of-state competitors have the capacity to fully supply that portion of the Ohio ethanol market presently being filled by New Energy should New Energy withdraw from that market. There is nothing in the record to evidence that South Point Ethanol, the only Ohio producer, had the capacity to expand into any void in the Ohio market. The Ohio Court of Appeals found that the evidence indicates that if New Energy left the Ohio market "the primary beneficiaries would be Illinois and Tennessee producers of ethanol . . . ." J. St. App. 46a. The record fully supports this finding by the Ohio Court of Appeals. One of the Illinois producers (Archer Daniels Midland "ADM") is the largest and most aggressive producer and it has the full capacity to fill any void in the Ohio market. JA 28, ¶17, 77-80. Unlike New Energy's assertions which are based solely on assumptions and speculation, the finding of the Ohio Court of Appeals was based on record evidence.

The use of leaded gasoline in motor vehicles is one of the major contributors to air pollution in this country. 49 Fed. Reg. at 31,036, 31,038 (1984). It is a legitimate goal of both the federal and state governments to reduce the level of pollutants caused by the use of leaded gasoline in motor vehicles. JA 113. Ethanol is the most cost-effective and environmentally benign replacement for lead in gasoline. JA 25, ¶10, 112. It is not disputed that there are major health benefits to the public from replacing lead with ethanol in gasoline. JA 112-113.

Because of these benefits, and because ethanol provides an alternate renewable source of fuel which decreases the dependency on foreign oil and a market for the country's surplus corn, both the federal government and many states have enacted legislation providing incentives to encourage the production and use of ethanol. The majority of state incentive programs use tax credits to subsidize the use of ethanol. The ethanol market

in Ohio would not exist or would at least be substantially smaller without the subsidy provided by Ohio's tax credit because without the credit ethanol could not compete with gasoline. JA 64-65, 73-77, 100, 147-149.

One of the purposes of the Ohio General Assembly in enacting Ohio Revised Code 5735.145(B) was to provide a cleaner and safer environment by encouraging the use of ethanol as a substitute for lead in gasoline not only in Ohio but in all states. The Ohio Supreme Court found that Ohio Revised Code 5735.145(B) was not an "economic protectionism" measure, but rather was intended to effect this legitimate state purpose. J. St. App. 6a. It is undisputed that the providing of tax incentives is the best method of encouraging such use. JA 25-26, ¶11.

The record is devoid of any evidence supporting New Energy's repeated assertion that the sole purpose of Ohio Revised Code 5735.145(B) was a parochial attempt to protect local ethanol producers against out-of-state competitors. The record fails to establish that this was either the purpose or the effect of the reciprocity provision.

### SUMMARY OF ARGUMENT

I. Ohio Revised Code 5735.145(B) is not invalid under the Commerce Clause. That provision is a part of Ohio's statutory scheme intended to encourage the use of ethanol as a substitute for lead in gasoline by providing a subsidy in the form of a tax credit. One of the purposes for encouraging such use of ethanol is to advance the health and welfare of Ohio's citizens by providing a cleaner and safer environment. The challenged reciprocity provision of the statutory scheme restricts the tax credits provided to dealers to ethanol produced in Ohio or any other state which provides similar credits for the use of Ohio-produced ethanol.

Even if this reciprocity provision has the effect of reducing the flow of ethanol in the interstate market, it

is not in violation of the Commerce Clause because the action taken by Ohio through its statutory scheme is not the type of action that is subject to the restraints of the Commerce Clause. *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794 (1976); *Reeves, Inc. v. Stake*, 447 U.S. 429 (1980); *White v. Massachusetts Council of Const. Employers*, 460 U.S. 204 (1983).

These cases hold that when a state or local government has entered the market as a participant rather than a regulator it is not subject to the strictures of the Commerce Clause. As did Maryland through its bounty scheme in *Alexandria Scrap*, Ohio through its ethanol tax credit has entered the market through a state-funded subsidy to stimulate the market by making ethanol more economically attractive as an alternative for lead in gasoline. Ohio has not attempted to regulate the market, it has simply exerted a market force to make ethanol competitive with gasoline. The Ohio legislation falls directly under the rule in *Alexandria Scrap*.

Nor should the strictures of the Commerce Clause apply to state subsidy programs which utilize various methods to encourage local industry in a market which owes its existence, in whole or in substantial part, to the subsidies provided under the state program. Thus, even if Ohio's program favored Ohio producers over out-of-state producers, it should not be invalidated under the Commerce Clause because the Ohio ethanol market would not exist, or would be substantially smaller, without the subsidy program.

II. Even if the Ohio statutory scheme is subject to the restraints of the Commerce Clause, the reciprocity provision is not invalid under that clause. The reciprocity provision is not an "economic protectionist" measure nor does it effect an absolute ban on the flow of ethanol in the interstate market. Therefore, the provision is valid under the Commerce Clause unless the incidental burden on interstate commerce is clearly excessive in relation to the putative local benefits advanced by the provision.

As the Ohio Supreme Court properly found, the reciprocity provision passes this test. The provision is intended to effectuate a compelling state interest, a healthier and safer environment, and any incidental burden on interstate commerce effected by the provision is not clearly excessive in relation to the local benefits to the health of the people of Ohio advanced by the legislation.

The reciprocity provision is not an "economic protectionist" measure designed to provide a commercial advantage to Ohio ethanol producers over all out-of-state producers. The provision does not restrict the ethanol credit to Ohio-produced ethanol. It is available for the use of ethanol produced in any state which grants incentives similar to the Ohio scheme. The purpose of the provision is to encourage other states to enact similar ethanol incentive programs. Such incentives are essential to enable ethanol to compete economically in the marketplace with gasoline. The ethanol industry cannot survive without such incentives.

The record contains no evidence of a discriminatory purpose behind the reciprocity provision nor does it establish that it has had a discriminatory effect. Only one interstate participant, New Energy, has been shown to have been adversely affected by the provision. There is no evidence that any of the out-of-state producers have been disadvantaged or that the sole Ohio producer has been advantaged. This is not a discriminatory effect. *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456 (1981); *Exxon Corp. v. Maryland*, 437 U.S. 117 (1978).

The Ohio reciprocity provision, unlike the provisions in the cases relied on by New Energy, does not result in an absolute ban on the flow of a product in interstate commerce. No ethanol producer, including New Energy, is prohibited from selling or distributing ethanol in Ohio. Because of the absence of an absolute ban on the interstate flow of ethanol, the reciprocity provision is not subject to the strict scrutiny standard applied by this Court in cases involving absolute bans on interstate commerce.

## ARGUMENT

OHIO REVISED CODE 5735.145(B) WHICH RESTRICTS THE SUBSIDY PROVIDED BY THE OHIO ETHANOL TAX CREDIT TO DEALERS WHICH USE ETHANOL PRODUCED IN OHIO AND IN ANY OTHER STATE WHICH GRANTS SIMILAR INCENTIVES DOES NOT VIOLATE THE COMMERCE CLAUSE.

### **I. The Reciprocity Provision Of The Ohio Ethanol Tax Credit Statute Does Not Impose The Type Of Burden Which The Commerce Clause Sought To Prohibit.**

In 1981, the Ohio General Assembly enacted Ohio Revised Code Section 5735.145 (139 Ohio Laws 1731) providing a credit against the Ohio motor vehicle fuel tax imposed on motor vehicle fuel dealers for each gallon of ethanol that is blended with gasoline and is used, sold or distributed by the dealer as motor vehicle fuel. At the time the ethanol tax credit was first enacted, the credit was available to dealers regardless of the source of the ethanol.

The subsidy provided to dealers by the tax credit was intended as an incentive to encourage Ohio dealers to use ethanol as a substitute for lead in gasoline. Such use of ethanol was encouraged because of the significant health benefits that will result from its use in place of the highly pollutant lead. J. St. App. 6a; JA 25-27, 136.<sup>1</sup> New Energy agrees that encouragement of the use of ethanol as a substitute for lead in gasoline is a legitimate goal for state governments. JA 112-113. The federal government has also determined that such use of ethanol

<sup>1</sup> The Ohio General Assembly may well have had other purposes in mind in deciding to enact the credit: providing an additional market for the sale of corn, the main raw material used to produce ethanol, and producing an alternate and renewable source of fuel, thereby reducing the dependency on foreign oil.

is worthy of encouragement and has provided various incentives to its use. JA 25-26, ¶11.

The subsidy provided to dealers by the tax credit is necessary in order to make the use of ethanol economically competitive *vis a vis* gasoline, because ethanol costs more to produce than gasoline. JA 65-66, 73-77, 100, 147-149. As New Energy has admitted in its brief (at 6, n.2), absent the Ohio credit ethanol is economically unattractive to motor vehicle fuel dealers.

While initially the state subsidy was made available to dealers for the use of ethanol without any restriction regarding its source, the Ohio General Assembly amended its ethanol tax credit statute by adding, *inter alia*, the reciprocity provision that is the subject of the constitutional challenge at issue in this case. This provision, Ohio Revised Code 5735.145(B), effective January 1, 1985, provided that the credit was not available for the use of ethanol produced outside Ohio unless the state in which it was produced provided similar credits for the use of Ohio-produced ethanol.

The State appellees ("State") do not dispute that the practical effect of this amendment, subsequent to Indiana's repeal of its ethanol credit, has been to adversely affect New Energy's competitive position in the Ohio market because Ohio dealers will not be eligible for the Ohio subsidy for using ethanol produced by New Energy.<sup>2</sup> The evidence in the record does not, however, indicate that the reciprocity provision effected a reduction in the total movement of ethanol in the interstate market.<sup>3</sup> Ethanol produced by all other out-of-state producers competing

<sup>2</sup> The record does not establish that any other competitor in the Ohio ethanol market was adversely affected by the amendment nor does it establish that the sole Ohio producer, appellee South Point Ethanol, has benefited from New Energy's probable loss of its market share in Ohio.

<sup>3</sup> See *infra*, Part II. A., at 22-23.

in the Ohio market continued to qualify for the subsidy. JA 28, ¶17.

However, even if the reciprocity provision is found to have the effect of reducing to some extent the flow of ethanol in the interstate market, the provision is not violative of the Commerce Clause because any such burden effected by the limitation on the goods for which the Ohio subsidy is made available is not the type of barrier sought to be prohibited by the Commerce Clause. The ethanol credit reciprocity provision falls squarely under the rule established by this Court in *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794 (1976), and reaffirmed in *Reeves, Inc. v. Stake*, 447 U.S. 429 (1980) and *White v. Massachusetts Council of Const. Employers*, 460 U.S. 204 (1983).

In *Alexandria Scrap*, this Court considered a Commerce Clause challenge to a Maryland statutory scheme which provided a state funded bounty to automobile scrap processors to encourage the destruction of automobile hulks abandoned in the State. The part of the statutory scheme challenged was an amendment which required the scrap processors to submit title documentation to the State to qualify for the bounty. This amendment imposed more burdensome documentation requirements on out-of-state scrap processors than on in-state processors. The Court found that the amendment gave Maryland scrap processors an advantage over out-of-state processors. *Id.*, at 802. "The practical effect was substantially the same as if Maryland had withdrawn altogether the availability of bounties on hulks delivered by unlicensed suppliers to licensed non-Maryland processors." *Id.*, at 803, n. 13. This Court concluded that the result of the amendment was a reduction in the movement of automobile hulks in interstate commerce. *Id.*, at 803.

Although this Court found that the challenged amendment resulted in such a reduction, it upheld the Maryland statute because, this Court held, the action taken by the Maryland statutory scheme was not "the kind of

action with which the Commerce Clause is concerned." *Id.*, at 805. This Court distinguished Commerce Clause cases in which a state burdened interstate commerce by prohibitions or regulations:

The common thread of all these cases is that the State interfered with the natural functioning of the interstate market either through prohibition or through burdensome regulation. By contrast, Maryland has not sought to prohibit the flow of hulks, or to regulate the conditions under which it may occur. Instead, it has entered into the market itself to bid up their price.

*Id.*, at 806. As this Court expressly noted, it had never "been asked to hold that the entry by the State itself into the market as a purchaser, in effect, of a potential article of interstate commerce creates a burden upon the commerce if the State restricts its trade to its own citizens or businesses within the State." *Id.*, at 808. This Court answered by holding that "[w]e do not believe the Commerce Clause was intended to require independent justification for such action." *Id.*, at 809.

*Alexandria Scrap* renders New Energy's reliance on prior Commerce Clause cases nugatory because it explicitly distinguished between the burden imposed in any of the Court's prior cases and that imposed by the Maryland statutory scheme:

But no trade barrier of the type forbidden by the Commerce Clause, and involved in previous cases, impeded their movement out of State. They remain within Maryland in response to market forces, including that exerted by money from the State. Nothing in the purposes animating the Commerce Clause prohibits a State, in the absence of congressional action,<sup>19</sup> from participating in the market and exercising the right to favor its own citizens over others.<sup>20</sup> (Footnotes omitted)

*Id.*, at 810.

The rule of *Alexandria Scrap* was followed by this Court in *Reeves, Inc. v. Stake, supra*, and *White v. Massachusetts Council of Const. Employers, supra*. In *Reeves*, this Court, relying on *Alexandria Scrap*, upheld against a Commerce Clause challenge a South Dakota policy to restrict the sale of cement produced by a state-owned plant to residents of the State. This Court left no doubt remaining regarding its belief that the rule it enunciated in *Alexandria Scrap* was correct:

The basic distinction drawn in *Alexandria Scrap* between States as market participants and States as market regulators makes good sense and sound law.

447 U.S., at 436. In fact, even Justice Powell in his dissent expressly noted his agreement with the rule established in *Alexandria Scrap*. *Id.*, at 447, n.1, 451-452.

In *White*, this Court reaffirmed the rule of *Alexandria Scrap* in upholding a policy of the City of Boston which required private contractors to give hiring preference to city residents as a condition of obtaining public-funded construction contracts. This Court summarized the holdings of *Alexandria Scrap* and *Reeves*:

*Alexandria Scrap* and *Reeves*, therefore, stand for the proposition that when a state or local government enters the market as a participant it is not subject to the restraints of the Commerce Clause.

460 U.S., at 208. Consistent with this general rule, the Court held that because the city was acting as a market participant, the Commerce Clause did not bar the residency conditions demanded by the city from participants. The impact of the policy on out-of-state residents was held to be relevant only if the city was regulating the market rather than acting as a participant.

*Id.*, at 210. In determining whether the city was acting as a market participant, the Court held that where the city expended its own funds in entering into construction contracts it was a market participant. *Id.*, at 214-215. As in *Reeves*, the dissent in *White* expressly accepted the correctness of the rule in *Alexandria Scrap. Id.*, at 216.

The Ohio statutory scheme for encouraging the use of ethanol falls within the rule of *Alexandria Scrap*. Ohio grants a state-funded subsidy in the form of a tax credit to motor vehicle fuel dealers which use ethanol to make gasohol. This credit was intended as an incentive to encourage the use of ethanol as a substitute for lead in gasoline. Such a subsidy was necessary in order to make the use of ethanol competitive *vis a vis* gasoline because ethanol is more costly to produce than gasoline. JA 64-65, 73-77, 100, 147-149.

Ohio has not sought to prohibit the interstate flow of ethanol or to regulate the conditions under which it may occur.<sup>4</sup> Rather, like Maryland in *Alexandria Scrap*, Ohio has merely entered into the market to make the use of ethanol more attractive in the marketplace. Ohio is not regulating, it is exerting a market force. Even assuming that the challenged reciprocity provision has resulted in an impact on the interstate flow of ethanol, it is only because the market force exerted by Ohio has made it more lucrative for dealers to purchase ethanol from producers whose states provide ethanol credits similar to that of Ohio. This is the exact effect imposed by the Maryland scheme upheld in *Alexandria Scrap*. 426 U.S., at 806.

The tax credit provided to dealers by the Ohio statute operates in virtually the same manner as the Maryland bounty provided to scrap processors. Both involve the

<sup>4</sup> No out-of-state ethanol producer is prohibited from selling its product in Ohio, nor are any conditions placed upon such producers' ability to so act in any regulatory sense.

expenditure of state funds in the marketplace as an incentive to effect a legitimate state purpose.<sup>5</sup> Neither interferes with the natural functioning of the interstate market by prohibition or burdensome regulation. The fact that the market force exerted by the Maryland scheme is in the form of a bounty while Ohio utilizes a tax credit is a distinction without a difference. While the form of the subsidy may differ, the substance is the same. In both cases, the state is spending its own money. Justice Stevens recognized this fact in his concurring opinion in *Alexandria Scrap*. 426 U.S., at 816. See also Regan, *The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause*, 84 Mich. L.Rev. 1091, 1193-1194 (1986). Because Ohio is expending its own funds by granting tax credits to subsidize the use of ethanol, it was a market participant and thus falls under the rule of *Alexandria Scrap*.

There is another close similarity between the Maryland statutory scheme involved in *Alexandria Scrap* and the Ohio ethanol tax credit provision. The commerce which each of the provisions was claimed to have burdened was created, in whole or in substantial part, by the subsidies provided under those provisions. In his concurring opinion in *Alexandria Scrap*, Justice Stevens saw this feature as an additional basis for upholding the Maryland scheme. Justice Stevens did not believe that the Commerce Clause prohibited states from utilizing various methods to encourage local industry in a market which owes its existence to a state subsidy program. 426 U.S., at 815-816. Justice Stevens' reasoning for such a rule is compelling:

The absence of any previous challenge to such programs reflects, I believe, a common and

<sup>5</sup> The major distinction is the fact that the Maryland scheme admittedly favored Maryland processors over all out-of-state processors while the Ohio credit does not favor Ohio ethanol producers over all out-of-State producers.

correct interpretation of the Commerce Clause as primarily intended (at least when Congress has not spoken) to inhibit the several States' power to create restrictions on the free flow of goods within the national market, rather than to provide the basis for questioning a State's right to experiment with different incentives to business.

*Id.*, at 817. The majority opinion noted that had the facts in that case been clear on that issue it would have been inclined to so rule. *Id.*, at 809, n.18.

The interstate flow of ethanol which New Energy claims is burdened by the challenged reciprocity provision would not exist without the tax credit provided by Ohio. As New Energy's president admitted, without the credit ethanol could not compete with gasoline. JA 64-65, 73-77, 100, 149. Because the interstate commerce which New Energy claims is burdened by the reciprocity provision owes its existence, in whole or in substantial part, to the subsidy provided by the Ohio statutory scheme, that claimed burden does not fall within the strictures of the Commerce Clause.

**II. Because Ohio Revised Code 5735.145(B) Is Not An Economic Protectionist Measure And Any Incidental Burden On Interstate Commerce Effected By The Provision Is Clearly Outweighed By The Local Benefits To The Health And Safety Of The People Of Ohio Advanced By The Legislation, The Provision Does Not Violate The Commerce Clause Of The United States Constitution.**

**A. Ohio Revised Code 5735.145(B) Is Not An "Economic Protectionist" Provision.**

New Energy asserts that Ohio Revised Code 5735.145(B) discriminates against interstate commerce, thereby violating the Commerce Clause of the United States

Constitution. In advancing this argument, New Energy relies on Commerce Clause cases considering statutes inapposite to Ohio Revised Code 5735.145(B). Because of this misplaced reliance, it is important to note at the outset what Ohio Revised Code 5735.145(B) does not do. It does not grant a credit solely for Ohio-produced ethanol (unlike the statutes struck down in *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984) and *Archer Daniels Midland Co. v. State*, 315 N.W. 2d 597 (Minn. Sup. Ct. 1982) ("*ADM Minn.*")). It does not tax the use of ethanol differently depending solely on whether the ethanol was produced in Ohio or out of Ohio (unlike the tax provisions stricken in *Armco, Inc. v. Hardesty*, 467 U.S. 638 (1984), and *National Meat Ass'n. v. Deukmejian*, 743 F. 2d 656 (9th Cir. 1984), *aff. without opinion*, 105 S.Ct. 768 (1985)). Nor does it operate to provide a direct commercial advantage to local ethanol producers over all out-of-state producers (unlike the tax provision declared invalid in *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318 (1977)). Ohio Revised Code 5735.145(B) does not ban the sale of ethanol produced in other states from the Ohio market (unlike the statute stricken in *Philadelphia v. New Jersey*, 437 U.S. 617 (1978)), nor does it ban the sale of products manufactured in other states not having a reciprocal provision from the Ohio market (unlike the statute invalidated in *Great A & P Tea Co. v. Cottrell*, 424 U.S. 366 (1976)).

Ohio Revised Code 5735.145(B) does not operate in the same manner as any of the statutes involved in any of the cases relied on by New Energy. The statute simply provides that in order for ethanol produced in another state to qualify for the credit available to motor vehicle fuel dealers who use such ethanol in creating gasohol, the state in which the ethanol is produced must also provide similar benefits for ethanol produced in Ohio.

In considering the Commerce Clause challenge to this enactment the Ohio courts properly rejected the urging by New Energy to expand this Court's holdings in Commerce Clause cases beyond the factual

circumstances of those cases. The Commerce Clause does not stand as an absolute prohibition against all legislation having an effect on interstate commerce. New Energy's attempt to so color the Commerce Clause, and the cases decided thereunder, is belied by language in those very cases upon which New Energy relies:

On various occasions when called upon to make the delicate adjustment between the national interest in free and open trade and the legitimate interest of the individual States in exercising their taxing powers, the Court has counseled that the result turns on the unique characteristics of the statute at issue and the particular circumstances in each case. *E.g.*, *Freeman v. Hewitt*, *supra*, at 252, 91 L.Ed. 265, 67 S.Ct. 274. This case-by-case approach has left "much room for controversy and confusion and little in the way of precise guides to the States in the exercise of their indispensable power of taxation."

*Boston Stock Exchange v. State Tax Commission*, *supra*, at 329.

New Energy consciously avoids "the distinction established by this Court between 'protectionist' measures employed by states to favor local businesses and measures employed by states to safeguard the health and safety of their people." *National Meat Ass'n v. Deukmejian*, *supra*, at 659. It is only "protectionist" measures that are subject to a virtually *per se* rule of invalidity. Measures employed to safeguard the people of the state which have an incidental effect on interstate commerce "will be upheld unless the burden on such commerce is clearly excessive in relation to the putative local benefits." *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970).

When the chaff is removed from New Energy's Commerce Clause argument what remains is the assertion that Ohio Revised Code 5735.145(B) is nothing more than simple "economic protectionism" enacted to favor local

ethanol producers at the expense of all out-of-state producers. However, New Energy was required to do more than merely assert that the statute was such a "protectionist" measure—it was required to establish this fact by the presentation of evidence. Each of the Ohio courts properly found that the enactment was not shown factually or legally to constitute "economic protectionism".

A finding that legislation constitutes nothing more than simple "economic protectionism" can be made only if it is demonstrated that it has a discriminatory purpose or a discriminatory effect. *Bacchus Imports, Ltd. v. Dias*, *supra*, at 270.<sup>6</sup> New Energy failed to meet its burden of establishing the existence of a discriminatory purpose or effect. It presented no evidence regarding the purpose of the General Assembly in enacting Ohio Revised Code 5735.145(B). It simply jumps to the conclusion that the purpose of the provision was to give a commercial advantage to local manufacturers of ethanol. This conclusion is supported neither by any evidence in the record nor by the face of the statutory provision. Based on the record and the statute, the holding of the Ohio Supreme Court that the enactment had neither a discriminatory purpose or effect is unassailable.

Unlike the Hawaiian statute struck down in *Bacchus* or the Minnesota ethanol credit stricken in *ADM Minn.*, Ohio Revised Code 5735.145(B) does not grant an exemption only to a locally produced product. In *Bacchus*, it was not disputed that the sole purpose of the exemption for okolehao and pineapple wine was to encourage and promote local industry. 468 U.S., at 270-271. Neither the Hawaiian exemption nor the Minnesota credit was

<sup>6</sup> A review of this Court's decisions indicates that the Court has been primarily concerned with discriminatory purpose and has looked at discriminatory effect as significant evidence of discriminatory purpose. See *Regan*, *supra*, at 1094-1098.

available to the same products produced in any other state.

Ohio Revised Code 5735.145(B) cannot logically be viewed as an attempt by the Ohio General Assembly to effectuate a discriminatory purpose by providing a commercial advantage to Ohio-produced ethanol. If that was the desire of the General Assembly, it would have enacted a provision that would restrict any tax credits solely to Ohio-produced ethanol or a direct subsidy program for Ohio producers. Rather, the General Assembly enacted Ohio Revised Code 5735.145(B) which provided a credit for gasohol created with ethanol produced not only in Ohio, but in any other state which granted similar ethanol use incentives.

Because of the vigorous competition among producers involved in the Ohio ethanol market, including large out-of-state producers whose ethanol would qualify under Ohio Revised Code 5735.145(B), the General Assembly was obviously aware of the fact that enactment of that provision would not give Ohio ethanol manufacturers a commercial advantage. Still, the General Assembly did enact Ohio Revised Code 5735.145(B). The reason it was enacted is because it was not intended to protect Ohio producers against out-of-state competition, but rather, to effectuate a legitimate state purpose.

It is common knowledge that leaded gasoline is one of the major sources of air pollution in this country. A primary purpose of the Ohio General Assembly in enacting Ohio Revised Code 5735.145 was to encourage the use of ethanol as a substitute for lead in gasoline. This purpose clearly advances the health and safety of the citizens of Ohio by providing a cleaner and safer environment. New Energy's repeated arguments below that no public health benefit is served by encouraging the use of ethanol as a substitute for lead in gasoline was belied by the testimony of its own president. Mr. Direnfeld testified that he agreed "that there are major health benefits to the public from the use of ethanol incorporated in gasoline

as opposed to the lead . . .", JA 112, and that to encourage the use of ethanol as a substitute for lead in gasoline is a legitimate goal for both the federal and state governments. JA 112-113. New Energy also stipulated that ethanol was the most environmentally benign replacement for lead in gasoline as well as the most cost effective. JA 25, ¶10.

New Energy attacks the wisdom of the means chosen by the Ohio General Assembly to carry out its purpose of providing a safer environment by arguing that the ethanol produced in a state without a reciprocal credit is no less desirable from a public health standpoint than ethanol produced in a reciprocating state. This misses the point of why the provision is important to the accomplishment of the goal of providing a safer environment.

The goal is not simply to encourage use of ethanol in Ohio, but to encourage its use in other states, particularly those in close geographical proximity to Ohio. Encouragement of the use of ethanol simply by dealers within Ohio would only partially advance the legislative purpose. Unless ethanol is used in other states, including the five states which border Ohio, the purpose of providing a cleaner and safer environment in Ohio would be hindered. A significant number of motor vehicles of nonresidents travel in and through Ohio every day. Additionally, even if these vehicles are not driven in Ohio, they will still pollute the atmosphere which will reach Ohio.

Unless the states in which those residents live also provide incentives for the use of ethanol, it is unlikely that they will use the more environmentally benign ethanol mixture in their vehicles. This is so because, as the testimony of New Energy's president reveals, without both state and federal incentives ethanol producers cannot compete price-wise with gasoline. If gasohol cannot be priced equal to or less than gasoline its use will obviously suffer. It must be remembered that what is sought to be encouraged is the use of ethanol in not only Ohio but

also in the other states. The mere granting of a credit for use of ethanol blended for use in Ohio will do nothing to encourage such use in other states. If the fuel dealers in other states receive no credits for using ethanol, they will not do so because they will not be able to compete with dealers selling lower cost gasoline. In fact, without state incentive programs for ethanol, the industry itself is in jeopardy.

Even assuming that one of the purposes of the enactment was to promote the domestic ethanol industry, that would not by itself render the enactment invalid under the Commerce Clause. This was made clear by a recent statement on the subject by this Court. In *Metropolitan Life Insurance Co. v. Ward*, 470 U.S. 869, 876-877 n.6 (1985), this Court recognized that "promotion of local industry is a legitimate state interest in the Commerce Clause context . . . ." The Court reaffirmed that "a state may enact laws pursuant to its police power that have the purpose and effect of encouraging local industry" as long as it does not "impose a discriminatory burden upon the business of other States, merely to protect and promote local business." (quoting from *Bacchus*, emphasis added) *Id.* Similarly, in *American Trucking Associations, Inc. v. Scheiner*, 107 S.Ct. 2829, 2941 (1987), this Court noted that what the Commerce Clause prohibits is "a state tax that favors in-state business over out-of-state business for no other reason than the location of its business . . ." (emphasis added).

Promotion of the local ethanol industry was clearly not the sole or primary purpose of Ohio Revised Code 5735.145(B). By its basic nature a reciprocity provision is not designed solely or primarily to favor domestic industry against all foreign competition. Ohio Revised Code 5735.145(B) clearly does not operate in a manner that "gives the home team an advantage by burdening all foreign corporations seeking to do business within the State, no matter what they or their States do." *Metropolitan Life Insurance Co. v. Ward*, *supra*, at 878.

Nor has New Energy met its burden of demonstrating that the challenged provision will have a discriminatory effect by causing Ohio-produced ethanol to gain a larger share of the Ohio market at the expense of out-of-state producers. New Energy has simply relied on cases in which the statutes in issue provided credits, exemptions or lower tax rates only for in-state activity. For example, in the *ADM Minn.* case, the statute granted a tax credit only for gasohol made with ethanol distilled in Minnesota and produced by agricultural products grown in Minnesota. No reciprocity was granted to ethanol produced in a state other than Minnesota. The same is true regarding the tax exemption invalidated in *Bacchus*.

Similarly, in *National Meat Association v. Deukmejian*, *supra*, the statute taxed all out-of-state beef processors and taxed no in-state beef processors. In *Armco*, the gross receipts tax exemption was available only to local manufacturers. The tax provision struck down in *Boston Stock Exchange* imposed a higher tax on security transfers resulting from out-of-state sales than on those resulting from in-state sales. In *Pike v. Bruce Church, Inc.*, *supra*, the statute stricken required cantaloupe growers to pack their cantaloupes in Arizona. In *Tyler Pipe Industries, Inc. v. Washington Dept. of Revenue*, 107 S.Ct. 2810 (1987), the Washington multiple activities exemption to its manufacturing tax results in a situation that "exposes manufacturing or selling activity outside the state to a multiple burden from which only the activity of manufacturing in-state and selling in-state is exempt." 107 S.Ct., at 2820.<sup>7</sup>

A common thread runs through each of these cases relied on by New Energy: the statutes involved in each case provided an advantage only to local industry which

<sup>7</sup> Significantly, in each of these cases the only discernible purpose of the challenged provisions was to advance local interests at the expense of out-of-state competitors. The effect of these statutes evidence that this was the purpose of those provisions.

resulted in a direct commercial advantage to such industry at the expense of all out-of-state competitors. This thread of unconstitutionality is not present in Ohio Revised Code 5735.145(B).

Ohio Revised Code 5735.145(B) does not operate on its face or in its practical effect to the disadvantage of all out-of-state ethanol producers. It does not provide a credit for only Ohio-produced ethanol. It is available for ethanol produced in any other state of the union which provides a similar credit or exemption for the use of ethanol. This is not just an appearance of availability designed to abort a Commerce Clause challenge, it is a fact. At the time of the enactment of Ohio Revised Code 5735.145(B), approximately thirty-two (32) states had some form of ethanol tax credit or exemption, including the State of Illinois where the largest producer of ethanol, ADM, is located. ADM, as well as Pekin Energy, which is also located in Illinois, and A.E. Staley, which is located in Tennessee, are all competitors in the Ohio market and ethanol produced by each of these entities is entitled to the Ohio credit.

Because the tax provision involved in the cases relied on by New Energy were available only for local activities, they necessarily had a discriminatory effect against out-of-state activity. They did not operate even-handedly. Unlike those provisions, the Ohio credit is available for the use of out-of-state produced ethanol and is in fact being granted for such use. Therefore, Ohio Revised Code 5735.145(B) will not necessarily cause Ohio-produced ethanol to acquire a larger share of the market and out-of-state produced ethanol to constitute a smaller share. The fact that the provision may cause a shift in the Ohio market among out-of-state producers does not cause a discrimination against interstate commerce. *CTS Corp. v. Dynamics Corp.*, 107 S.Ct. 1637, 1649 (1987); *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 473 (1981); *Exxon Corp. v. Maryland*, 437 U.S. 117, 126-127 (1978).

As this Court noted in *Clover Leaf Creamery, supra*, at 474:

We stressed that the Commerce Clause "protects the interstate market, not particular interstate firms from prohibitive or burdensome regulations." (quoting from *Exxon Corp.*, 437 U.S., at 127-128).

Under the proper Commerce Clause analysis, in order to meet its burden of demonstrating a discriminatory effect, New Energy was required to establish that the statute will cause locally-produced ethanol to gain a greater share of the Ohio market and ethanol produced out-of-state to constitute a smaller share of the market. *Exxon Corp. v. Maryland, supra*, at 126, n.16. See also *White v. Massachusetts Council of Constr. Employers, supra*, at 209, n.6. New Energy has failed to prove such an effect.

In fact, rather than demonstrating that the provision will have the effect of favoring the Ohio producer by causing it to gain a greater share of the market, the evidence established just the contrary. Out-of-state ethanol producers whose product is entitled to the Ohio credit when used in a qualified manner by motor vehicle fuel dealers are fully capable of supplying that portion of the Ohio market supplied by New Energy. There is nothing in the record indicating that the sole Ohio producer, South Point Ethanol, would be able to capture any new markets from these out-of-state competitors. What testimony there is indicates that ADM is the largest and most aggressive producer, from which the logical assumption would be that they would be the producer most likely to gain an increased share of the Ohio market if New Energy ceases doing business in Ohio. In fact, New Energy has not even established that the Ohio producer has the capacity to fill any void in the market. Unless it is demonstrated that South Point has the capacity to fill any new market, Ohio Revised Code 5735.145(B) cannot possibly be found to have a discriminatory effect.

Having correctly determined that Ohio Revised Code 5735.145(B) did not constitute "economic protectionism" but rather a measure designed to protect the health and safety of the citizens of Ohio, the Ohio Supreme Court properly balanced the purpose of the Commerce Clause and the legitimate interest of the state in safeguarding the health and safety of its people. Given the significant benefits that will be served by encouraging the use of ethanol and the incidental effect the statute may have on interstate commerce, that Court properly upheld Ohio Revised Code 5735.145(B).

**B. Ohio Revised Code 5735.145(B) Does Not Impose An Absolute Ban On The Sale Of Ethanol Produced In Other States Regardless Of Whether Such States Grant Incentives To Ohio-Produced Ethanol; Therefore The Enactment Is Not Subject To The Strict Scrutiny Applied To Statutes That Impose Absolute Bans.**

The State does not dispute that under the balancing test applied by this Court in Commerce Clause cases, "[o]nly state interests of substantial importance" will save a statute the implementation of which will result in an absolute ban on the interstate flow of a product. *Great A & P Tea Co. v. Cottrell*, 424 U.S. 366, 375 (1976). Contrary to New Energy's assertion, however, whether a statute imposes an absolute ban is relevant because it is important in applying the balancing test. As the Ohio Supreme Court correctly discerned, in the absence of such a ban the statute is not subjected to the strict scrutiny standard.

It is the absence of such a ban that distinguishes Ohio Revised Code 5735.145(B) from the provision stricken in *Great A & P Tea Co.*, the major case relied on by New Energy. The Mississippi provision imposed an absolute ban against the distribution of Louisiana-produced milk products in Mississippi unless Louisiana accepted Mississippi-produced milk on a reciprocal basis. Unlike the Mississippi reciprocity provision, Ohio Revised Code

5735.145(B) does not ban any product from the Ohio market. Any ethanol producer is free to sell its product to Ohio dealers. This fact distinguishes that case from the instant one, and the distinction is constitutionally significant because it directly changes the balancing test. Because Ohio Revised Code 5735.145(B) does not impose an absolute ban, it is not subject to the strict scrutiny applied in *Great A & P Tea Co.*

Additionally, Mississippi's contention that its reciprocity provision served a vital state interest was found by this Court to border on the "frivolous." *Id.*, at 375. While Mississippi argued that the provision maintained the State's health standards, the Court found that it in fact disserved this purpose because it would allow out-of-state milk to be distributed in Mississippi even if it was lower than Mississippi's standards as long as the state in which it was produced had entered into a reciprocity agreement with Mississippi. *Id.* In the present case, as the Ohio Supreme Court found, Ohio Revised Code 5735.145(B) advances a legitimate state purpose, a healthier and safer environment.

As this Court has repeatedly recognized, each Commerce Clause case requires a case-by-case analysis balancing the particular state interests involved and the interest in free trade among the states. *Boston Stock Exchange v. State Tax Commission*, *supra*, 429 U.S., at 329. Because the effect of the absolute ban imposed by the Mississippi statute on interstate commerce was "devastating" and the asserted state interest was found to border on the "frivolous", the balancing weighed heavily against the statute. Unlike the Mississippi statute, any incidental burden on interstate commerce resulting from Ohio Revised Code 5735.145(B) is clearly outweighed by the very real health and safety benefits advanced by the provision.

The reciprocity provision stricken in *Sporhase v. Nebraska*, 458 U.S. 941 (1982), was also subjected to the "strictest scrutiny" test because it too imposed an absolute

ban on the shipment of items in interstate commerce. The statute absolutely prohibited the shipment of water from Nebraska to any state which did not permit its water to be shipped to Nebraska. Significantly, in *Sporhase*, this Court expressly recognized the difference between economic protectionism and health and safety measures which are at the very core of the state's police power. However, because of the absolute ban imposed by the statute the state was required to show that the provision was narrowly tailored to serve that purpose. Because the Court found that it was not so tailored, the statute did not survive the "strictest scrutiny" test.

Because Ohio Revised Code 5735.145(B) does not impose a ban on the shipment or sale in Ohio of ethanol produced in any state, it is not subject to the "strictest scrutiny" test. Furthermore, as detailed earlier in this argument, Ohio Revised Code 5735.145(B) is a health and safety measure and is narrowly tailored to serve the purpose of protecting its citizens by encouraging measures which will directly result in a safer and cleaner environment. Because it is so tailored, the statute could survive the "strictest scrutiny" test, even assuming, *arguendo*, that it was applicable.

The statute at issue in *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511 (1935), prohibited the sale of out-of-state produced milk in New York unless the price paid to producers was the same as that paid to New York producers. It, like the statutes in *Great A & P Tea Co.* and *Sporhase*, imposed an absolute ban unless other states complied with the statutory requirement. Additionally, the only plausible purpose of the provision was to protect the local milk industry. As such, it was simply an "economic protectionist" measure.

*Brown-Forman Distillery v. N.Y. State Liquor Auth.*, 106 S.Ct. 2080 (1986), involved a statute virtually identical in effect to that stricken in *Seelig*. The purpose was to directly regulate commerce by regulating activities of businesses in other states. In effect, the statute regulated the price

at which these out-of-state distillers could sell their liquor in other states. The failure by those businesses to comply with that regulation could result in the revocation of the distiller's license to sell alcoholic beverages in New York. Simply stated, unless the distiller complied with the New York regulation, it could be absolutely banned from selling its goods in New York. Additionally, as was the statute in *Seelig*, the statute in *Brown-Forman* was found by the Court to be an economic protectionist measure.

*Pike v. Bruce Church, Inc.*, *supra*, is also inapposite to this case. The statute involved in that case was found to have the effect of forcing growers to move their packing operations to the enacting state by prohibiting a grower from shipping its cantaloupes out of Arizona unless they were packed in Arizona. The Court noted that statutes requiring business operations to be performed in the home state were viewed with particular suspicion and that such a burden on commerce has been considered virtually *per se* illegal. 397 U.S., at 145. Ohio Revised Code 5735.145(B) contains no such requirement. It does not have the effect of forcing ethanol producers to locate in Ohio. In fact, as noted earlier, all of the major competitors other than New Energy continue to sell to Ohio dealers with no change or shifting in their operations. Additionally, unlike the grower in *Pike*, New Energy is not prohibited from shipping its product into Ohio.

*Pike* is also distinguishable because of the substantially different local interest sought to be advanced. The primary purpose of the Arizona legislation was to promote and preserve the reputation of Arizona growers, an interest which the Court labeled as "tenuous." 397 U.S., at 145. Balancing this "tenuous" state interest against the burden imposed on interstate commerce by requiring that a grower locate its business within the state, the Court found that the burden on interstate commerce was clearly excessive in relation to the local benefits.

It is particularly noteworthy that this Court distinguished this "tenuous" interest from legislation in the field of health

and safety "where the propriety of local regulation has long been recognized." *Id.*, at 143. The Court made it clear that the reason it struck down the legislation was due to the minimal nature of the state interest rather than the extent of the burden on interstate commerce:

Such an incidental consequence of a regulatory scheme could perhaps be tolerated if a more compelling state interest were involved. But here the State's interest is minimal at best

....

*Id.*, at 146.

*Hunt v. Washington State Apple Advertising Commission*, 432 U.S. 333 (1977), is similarly inapposite to this case. Initially, a reading of that decision reveals that there was at least a strong suspicion by the Court that the purpose of the challenged statute prohibiting any labeling containing state quality grades on closed containers of apples shipped into North Carolina was intended solely to give North Carolina growers a competitive edge. *Id.*, at 352-353. Second, the Court found that even if that was not the real purpose of the statute, the asserted purpose of protecting the consumers of the state was in fact disserved by the statute because it deprived them of all information regarding the quality of apples. Because the provision did not advance a legitimate state purpose, or did so only minimally, the burden on the flow of interstate commerce resulting from the additional repackaging costs and the loss of the competitive advantage Washington apples held in the marketplace was found to outweigh that state interest.

Not only is any incidental burden imposed on interstate commerce by Ohio Revised Code 5735.145(B) less than that imposed by the Arizona or North Carolina legislation, but Ohio's interest in providing a cleaner and safer environment is a compelling state interest, unlike the tenuous interest of the Arizona legislation or the suspect

purpose of the North Carolina statute.<sup>8</sup> Additionally, unlike the statute in *Hunt*, Ohio Revised Code 5735.145(B) does serve to advance the legitimate state purpose of assuring a safer environment. The burden imposed on interstate commerce by Ohio Revised Code 5735.145(B) is not excessive in relation to the very real health benefits sought to be obtained by cleaning up the environment. Because the balance falls in favor of the enactment, the Ohio Supreme Court properly upheld Ohio Revised Code 5735.145(B).

<sup>8</sup> A review of this Court's decisions declaring invalid provisions imposing absolute bans on the interstate flow of goods reveals that a major factor underlying those decisions was the Court's belief that the purpose of those provisions was protectionist. That factor is not present in this case. See Part II. A., *supra*.

**CONCLUSION**

For the foregoing reasons, the judgment of the Supreme Court of Ohio should be affirmed.

Respectfully submitted,  
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**CERTIFICATE OF SERVICE**

The undersigned hereby certifies that a copy of the foregoing Brief of Appellees, Joanne Limbach, Tax Commissioner of Ohio, Mary Ellen Withrow, Treasurer of Ohio, has been served by regular United States mail, first-class, postage prepaid, upon Herman Schwartz, Esq., 207 Myers Hall, 4400 Massachusetts Ave., N.W., Washington, D.C. 20016; David J. Young, Esq., Murphey, Young and Smith, 250 East Broad Street, Columbus, Ohio 43215, attorneys for appellant; and David C. Crago, Esq., 1900 Huntington Center, 41 South High Street, Columbus, Ohio 43215, attorney for appellee South Point Ethanol, on this \_\_\_\_ day of February, 1988. All parties required to be served have been served.

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No. 87-654

Supreme Court, U.S.

FILED

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IN THE  
**Supreme Court of the United States**

OCTOBER TERM, 1987

NEW ENERGY COMPANY OF INDIANA,  
*Appellant,*

v.

JOANNE LIMBACH,  
TAX COMMISSIONER OF OHIO, MARY ELLEN WITHROW,  
TREASURER OF OHIO, and SOUTH POINT ETHANOL,  
*Appellees.*

On Appeal from the Supreme Court of Ohio

APPELLANT'S REPLY BRIEF

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On Appeal from the Supreme Court of Ohio

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APPELLANT'S REPLY BRIEF

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**I. OHIO'S GRANT OF AN ETHANOL SALES TAX  
CREDIT DOES NOT MAKE IT A "MARKET PAR-  
TICIPANT" WITHIN THE MEANING OF *HUGHES*  
*v. ALEXANDRIA SCRAP CORP.*, 426 U.S. 794 (1976).**

In an eleventh hour effort, appellees seek shelter under the market participant doctrine, invoking a theory they did not raise in the Ohio courts. The State of Ohio seeks to place its sales tax credit reciprocity provision, R.C. 5735.145(B), entirely outside the Commerce Clause with the assertion that "because Ohio is expending its own funds by granting tax credits to subsidize the use of

ethanol it was a market participant and thus falls under the rule of [*Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794 (1976)]." Brief of Appellees Joanne Limbach, Tax Commissioner of Ohio, and Mary Ellen Withrow, Treasurer of Ohio (hereafter "Ohio Br.") pp. 13, 5.<sup>1</sup>

More modestly, Ohio and New Energy's Ohio competitor, appellee South Point Ethanol, assert that the Commerce Clause is not applicable to Ohio's sales tax credit because the commerce in ethanol "was created, in whole or in substantial part, by the subsidies provided," Ohio Br., pp. 13-14, "is dependent for its existence upon the very form of governmental incentives at issue on this appeals," Brief of Appellee South Point Ethanol ("South Point Br."), p. 2, and "is the result of massive state and federal investment," Brief of the State of Illinois as Amicus Curiae In Support of Appellees ("Illinois Br."), p. 3.

Acceptance of appellees' contentions would virtually eliminate Commerce Clause constraints from many if not most of the protectionist and discriminatory tax measures struck down by this Court as well as others, since all these measures could be said to involve an "expenditure" of the "state's own funds" insofar as they operate by foregoing some tax revenues while collecting others. Appellees' contentions also misconstrue the market participant doctrine, and are factually unfounded.

#### A. Sales Tax Credits Such as Ohio's Are Not Exempt From Commerce Clause Constraints.

Although "the line between 'market participant' and 'market regulator' is not always bright," *White v. Mass. Council of Constr. Employers*, 460 U.S. 204, 217-18 (1983) (Blackmun, J., dissenting), and has frequently

<sup>1</sup> "Ohio through its ethanol tax credit has entered the market through a state-funded subsidy to stimulate the market by making ethanol more economically attractive as an alternative for lead in gasoline." (p. 5).

divided the Court, it is clear that the grant of sales tax credits such as Ohio's, even if adopted to foster new or struggling industries, does not bring the doctrine into play.

The market participant doctrine, as explicated most fully in *Reeves Inc. v. Stake*, 497 U.S. 429 (1980), *South-Central Timber Development, Inc. v. Wunnicke*, 467 U.S. 82 (1984), (plurality) *White*, and *Alexandria Scrap*, deals with an "identifiable class of economic activity in which the city [or State] is a major participant," *White v. Mass. C'cil*, 460 U.S. at 211 n.7, as purchaser or seller. The "single inquiry [is] whether the challenged program constituted direct state participation in the market." *Id.* at 208. "State proprietary activity" must be involved, in which the State acts as a "private business," with the "long recognized right of trader and manufacturer, engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal," often "burdened with the same restrictions imposed on private market participants. [footnote omitted] Evenhandedness suggests that, when acting as proprietors, States should similarly share existing freedom from federal constraints, including the inherent limits of the Commerce Clause." *Reeves, Inc. v. Stake*, 447 U.S. at 438-439; *White v. Mass. C'cil*, 460 U.S. at 207 n.3. See also *id.* at 218-19 (Blackmun, J., dissenting); *South-Central Timber Development Inc. v. Wunnicke*, 467 U.S. at 96-99. As Justice Powell, author of *Alexandria Scrap*, explained,

"In procuring goods and services for the operation of government, a State may act without regard to the private marketplace and remove itself from the reach of the Commerce Clause. . . . These categories recognize no more than the 'constitutional line between the State as government and the State as trader.' *New York v. United States*, 326 U.S. 572, 579, 66 S. Ct. 310, 90 L. Ed. 326 (1946)."

*Reeves, Inc. v. Stake*, 447 U.S. at 450.

A plurality of the Court followed out the private-trader logic in *South-Central Timber* when it applied one of the "restrictions imposed" on "private market participants" by limiting to the immediate transaction Alaska's ability to require in-state processing of timber that it owned and sold, citing the common law on restraints on alienation and antitrust law. 467 U.S. at 98.

In enacting its sales tax credit, Ohio has manifested none of the attributes of a "private business," engaged in "propriety activity." Unlike Maryland, South Dakota and Massachusetts, Ohio bought nothing, manufactured nothing, and sold nothing. Instead, it has engaged in taxation, a quintessentially governmental act with a "political character," *Reeves, Inc. v. Stake*, 447 U.S. at 439 n. 12, an act that the Commerce Clause was directly concerned with. It has acted "as government" and not "as trader," *id.* at 450 (Powell, J.), and its activities directly implicate the Commerce Clause. As the Court observed in *Reeves, Inc. v. Stake*, "the Commerce Clause responds principally to state taxes and regulatory measures impeding free private trade in the national market place," citing Tribe, *American Constitutional Law* 336 (1978): "The Commerce Clause was directed, as an historical matter, only at regulatory ~~and~~ *taxing actions* taken by states in their sovereign capacity." (emphasis added) 447 U.S. 429, 436 (1980); see also *Hughes v. Alexandria Scrap Corp.*, 426 U.S. at 810 n.20 (indicating concern about "discriminatory taxes"). A sales tax credit designed to promote local industry is a prime example of such "taxing actions." See, e.g., *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984).

Ohio and South Point focus on the "expenditure" of state funds involved in the credit, and call this "market participation." They would equate such disparate matters as a state's differential taxation with a state's purchase of printing services for its own use, see *American Yearbook Co. v. Askew*, 339 F. Supp. 719 (M.D. Fla.

1972) (three-judges), cited in *Reeves*, 447 U.S. at 437 n. 9.

Such a broad-sweeping economic analysis, which does violence to the historical and other bases for both the Commerce Clause and the market participant doctrine, would "swallow up" the Commerce Clause. This Court has not accepted such reasoning. It has recognized the need to put "limits on state or local governments' ability to impose restrictions" in market participant cases. *White v. Mass. C'cil*, 460 U.S. at 211 n. 7, and has not been overly receptive to claims of economic equivalence. In *South-Central Timber*, for example, the Court refused to allow Alaska to require in-state processing of the timber it sold, even though Alaska effectively subsidized the processing by charging "a significantly lower price for the timber than it otherwise would," 467 U.S. at 85, and could have achieved the same economic effect by other means. *Id.* at 98-99.<sup>2</sup> In the intergovernmental tax area the Court has focused on the specific legal incidence of the tax, and not on the actual and often indeterminate economic burden. See Tribe, *American Constitution Law* (2d ed.) 514-521 (1988).

Furthermore, as the Court said in a different context,

The grant of a tax exemption is not sponsorship since the government does not transfer part of its revenue to churches but simply abstains from demanding that the church support the state. No one has ever suggested that tax exemption has converted libraries, art galleries, or hospitals into arms of the state or put employees 'on the public payroll.' . . . As Mr. Justice Holmes commented in a related context 'a page of history is worth a volume of logic.' *New York Trust Co. v. Eisner*, 256 U.S. 345, 349,

<sup>2</sup> The Court imposed a different kind of limitation when the market participant doctrine threatened to swallow up rights under the Privileges and Immunities Clause. *United Bldg. Trades Council v. Camden*, 465 U.S. 208 (1984). Cf. *Hicklin v. Orbeck*, 437 U.S. 518 (1978).

65 L. Ed. 963, 982, 41 S. Ct. 506, 16 ALR 660 (1921)."

*Waltz v. Tax Commission*, 397 U.S. 664, 675 (1970). Cf. *Marsh v. Chambers*, 463 U.S. 783 (1983) (history overrides rule of *Lemon v. Kurtzman*, 403 U.S. 602 (1971)). The claims of history are as great in Commerce Clause matters as anywhere else. See *Alexandria Scrap*, 426 U.S. at 809 n. 16.

Even when there is a market participation element, the Court has not always exempted state action from the Commerce Clause. In *Sporhase v. Nebraska*, 458 U.S. 941 (1982), the Court noted that "the natural resource has some indicia of a good publicly produced and owned in which a state may favor its own citizens in time of shortage. See *Reeves, Inc. v. Stake*, 458 U.S. at 957." The Court nevertheless struck down the reciprocity provision, applying strict scrutiny. In *South-Central Timber*, Alaska was selling its own logs and was subsidizing the processing, but that did not give it *carte blanche* to impose any conditions it wanted.

The reason for the Court's reluctance is obvious: appellees' approach could well result in the market participant doctrine "swallowing up the rule that States may not impose substantial burdens on interstate commerce even if they act with the permissible state purpose of fostering local industry." *South-Central Timber*, 467 U.S. at 98. Blatantly discriminatory tax levies could be imposed by raising taxes for all and giving credits to some. Exclusion can be achieved through selective taxation.<sup>3</sup>

<sup>3</sup> Thus, in *Great A&P Tea Co. v. Cottrell*, 424 U.S. 366 (1976), instead of imposing a ban on milk from states that refused to enter into a reciprocity agreement with Mississippi, if that State chose instead to create tax credits only for milk from states that entered into such agreements, then on appellees' reasoning, that measure would have been completely immune to Commerce Clause scrutiny, despite its being identical in purpose and effect to the measure Mississippi did adopt.

Appellees' position would require the reconsideration and almost certainly the overturning of a vast number of discriminatory tax cases, including many recent decisions. For example, in *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984), Hawaii imposed a 20% excise tax on sales of liquor at wholesale, but exempted (1) okolehao brandy in order to "encourage and promote the establishment of a new industry," and (2) pineapple wine, a "nonexistent . . . liquor industr[y]." The State tried to justify its exemptions because these were "struggling" industries. The Court rejected this flatly, saying

"we perceive no principle of Commerce Clause jurisprudence supporting a distinction between thriving and struggling enterprises under these circumstances, and the State cites no authority for its proposed distinction. In either event, the legislation constitutes 'economic protectionism' in every sense of the phrase. It has long been the law that States may not 'build up [their] domestic commerce by means of unequal and oppressive burdens upon the industry and business of other States.' *Guy v. Baltimore*, 100 U.S. 434, 443, 25 L. Ed. 743 (1880) . . . . [T]he propriety of economic protectionism may not be allowed to hinge upon the State's—or this Court's—characterization of the industry as either 'thriving' or 'struggling.'" 468 U.S. at 272-73.

That same term, the Court rejected an effort to uphold a franchise tax credit that served as a subsidy and an incentive to engage in export trade, a purpose Congress was also promoting. *Westinghouse Elec. Corp. v. Tully*, 466 U.S. 388, 405 (1984). The New York Tax Commission argued that the credit was "a subsidy to American export business generally," to which the Court unanimously replied, "a State may not encourage the development of local industry by means of taxing measures that 'invite a multiplication of preferential trade areas' within the United States, in contravention of the Commerce Clause. *Dean Milk Co. v. Madison*." 466 U.S. at

405. See also *Archer Daniels Midland Co. v. State*, — Minn. —, 315 N.W. 2d 597 (Minn. S. Ct. 1982) (tax credit may not be denied to out-of-state ethanol); *Miller v. Publicker Industries*, — Fla. —, 457 So. 2d 1374 (Fla. S. Ct. 1984) (same re foreign ethanol).

Similarly, in *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318 (1977), New York gave a tax credit to non-residents who engaged in stock transactions involving an in-state sale. The purpose was to reduce the competitive disadvantage New York was suffering from imposing a stock transfer tax. The Court unanimously ruled that the stock transfer tax reduction was discriminatory. These and many other cases involving tax credits, e.g., *Tyler Pipe Industries, Inc. v. Washington Dep't of Revenue*, 107 S. Ct. 2810 (1987); *Armco, Inc. v. Hardesty*, 107 U.S. 638 (1984); *Maryland v. Louisiana*, 451 U.S. 725 (1981), would all have to be reexamined and probably overturned if a state becomes a "market participant" simply by granting a sales tax credit.

In these decisions, the market participant doctrine was not even mentioned, and for good reason: A state sales or franchise tax credit is not "proprietary activity" in which the state acts like a "private business", "burdened with the same restrictions imposed on private market recipients."

Justice Scalia summed up some of the relevant considerations just last term in this way:

Courts can avoid arbitrariness in their review [of taxes on interstate and intrastate activities] only by policing the entire spectrum (which is impossible), by policing none of it, or by adopting rules which subject to scrutiny certain well-defined classes of actions thought likely to come at or near the discriminatory end of the spectrum. We have traditionally followed the last course, confining our disapproval to forms of tax that seem clearly designed to discriminate, and accepting the fact that some

amount of discrimination may slip through our net. *A credit against intrastate taxes falls readily within the highly suspect category. . . .*" *American Trucking Ass'n v. Scheiner*, 107 S. Ct. 2829, 2852 (1987) (dissent) (footnote omitted) (emphasis added).

#### **B. The Ethanol Market Was Not "Created" By the Tax Credit.**

South Point Ethanol argues that the ethanol commerce in question "is dependent for its existence upon the very form of governmental subsidy at issue in this appeal." South Point Br., p.2. The argument is factually unfounded and doctrinally irrelevant.

Appellees submitted virtually no evidence as to the "creation" of the ethanol market.

As appellant's Statement of the Case indicates, the energy crisis made ethanol a desirable motor fuel component. Publicly available official information and passing references in the record indicate that ethanol became commercially viable primarily because of the federal subsidy, and additionally with the aid of a wide variety of production grants, loan guarantees and other devices, almost all of which were provided by the federal government. See Illinois Br. pp. 6-8 n.5. A recent congressional study found that the federal government's array of incentives and particularly the exemption from the federal excise tax on gasoline, "made the use of 'gasohol' economically competitive; [and] the blend began appearing in the market in 1979." Siegel, Carr, Gelb & Melke, *Analysis of Possible Effects of H.R. 2052, Legislation Mandating the Use of Ethanol in Gasoline*, Cong'l Research Service Report for Congress 87-819 SPR, p.6 (Oct. 13, 1987). The Federal Department of Transportation records indicate there were ethanol sales in Ohio in 1979 and 1980, during the gasoline shortages, and before the legislation was enacted, Department of Transportation, *Highway Statistics Summary to 1985*, No. 050-001—00301-5 (undated) p. 21, and Brazilian pro-

ducers were also trying to sell in Ohio in the early 1980's, J.A. 101, 113; Transcript of March 1, Hg. 33-34, as well as elsewhere. See *Miller v. Publiker Industries, supra*.

The next great boost to ethanol sales came from the federal lead phase-down regulations in 1985, J.A. 101, 113, which made ethanol desirable as an octane enhancer to replace lead.

The record also indicates the importance of such other factors as the price of corn, J.A. 56, and the price of gasoline, J.A. 86. (The lower the corn price and the higher the gasoline price, the more competitive is ethanol.) Moreover, the importance of the kind of incentives used by other states like Indiana is demonstrated by the fact that Indiana was and remains one of the largest users of ethanol and New Energy continues to produce and sell ethanol, in Indiana and other states, e.g., Michigan, that have no tax or other incentive at all. Indeed, as noted in the appellant's Statement of the Case, numerous states have repealed their tax incentives, but ethanol usage has been rising sharply, and in many states like Indiana, Michigan, California and Colorado, without any incentives. See *Alcohol Outlook*, March 1988, p.6.<sup>4</sup> One cannot really know, therefore, how important the Ohio sales tax credit is. At the very least, there is no way to know how the Ohio ethanol market would have developed without Ohio's tax credit, given these other factors.<sup>5</sup>

<sup>4</sup> The absence or repeal of incentives is a matter of public record or public legislation, as is the increase in ethanol usage in these states. None of appellant's factual statements on this matter have been challenged.

The relevant page of the March 1988 issue of *Alcohol Outlook* is attached hereto as an Appendix.

<sup>5</sup> Appellees and Illinois suggest that the tax credit did not "drive" New Energy "out of the Ohio market;" Illinois Br. 16. Also, Ohio and South Point try to distinguish *A&P*, drawing a distinction

There is thus no basis for South Point's claim that the commerce in question was "made possible" by the Ohio legislation. Just as in *Alexandria Scrap*, where the record was ambiguous as to whether Maryland actually did create the market, the record is equally ambiguous here.

Moreover, a constitutional doctrine that turns on "creation", in "whole or substantial part" of a market, would be almost impossible to apply. How long does the exemption from the Commerce Clause apply—indeinitely, even when as here, it is clear the market can get along without the credit? Do the courts have to continuously review and evaluate when the market is sufficiently mature to do without the credits and should become subject to the Commerce Clause? And how "substantial" must a "substantial part" be? Here, Ohio had some ethanol trade in 1979-80 before its tax credit, which was adopted in 1981 when South Point was formed.<sup>6</sup>

What, indeed, does "creation" mean? Illinois strongly presses the point that Ohio created this market, but on the same page it notes that the "corn and cereal grain industry is also supported by massive state and federal involvement." Illinois Br. p.3. Does this mean that the supporting States are market participants and can, for example, limit sale of corn and cereal grains to in-staters? Can limit this industry's employment to in-staters? Compare *Reeves v. Stake* and *White v. Mass.*, *Civil* with *H.P. Hood and Sons v. Du Mond*, 336 U.S.

between an "absolute bar" and a tax. Ohio Br. 24-25. But if the latter is a meaningful distinction—and there is no reason to believe it is, given the trial court's finding as to the effect of the denial of the tax credit, J. 31, A. 58a—then this implies that New Energy was not barred from the Ohio market, and could compete there without the tax credit. If that is true, then that implies a market can exist without the sales tax credit and was not created by it.

<sup>6</sup> The record contains testimony that a tax credit is "not necessarily" the "best way" to provide incentives but only "the way it has been generally used." J.A. 113. But see J.A. 26. It is clearly not the only way.

525 (1949), *Hicklin v. Orbeck*, 437 U.S. 518 (1978), and *Hughes v. Oklahoma*, 441 U.S. 322 (1979). Suppose Ohio had financed research into a new kind of cereal grain or on technology lowering costs for ethanol production. Could it exclude products from a company in another state utilizing the fruits of that research? Suppose Ohio spent some money to support development of its natural resources. Could it prohibit the export of such resources? Compare *Sporhase*.

Appellees emphasize the testimony of New Energy's president that New Energy could not operate without the tax credit, as evidence that the commerce was "created" by the incentive. But that testimony related to conditions at that time—he referred to the comparative prices of gasoline and gasohol "at this time," his costs "today", and what New Energy could "currently do . . . today." J.A. 64-65. New Energy and ethanol's competitiveness would also change with increases in the gasoline price, J.A. 89, and did improve markedly when the lead phase-down rules became effective, shortly after the hearing. 40 CFR 80.20 (1987); J.A. 101-02. This was also a market where the other major competitors were receiving tax credits, see Transcript of March 29, 1985, p. 38 ("We have to be at the same price as they are or we couldn't sell.") Had Ohio not created a discriminatory tax structure, New Energy would have been able to participate in the Ohio market on a level playing field with the other market members, as in Indiana, where the termination of the credit was not fatal "because everyone loses that, not just the New Energy Company of Indiana." J.A. 90.<sup>7</sup>

In sum, appellees cannot avail themselves of the market participant doctrine to hide the sharp conflict between the Ohio forced reciprocity statute and the Commerce Clause.

<sup>7</sup> Illinois even suggests that New Energy could have continued in the Ohio market without the credit. See also the Ohio—South Point distinction between an "absolute ban" and the Ohio credit, p. 10 n.5.

## II. OHIO'S RECIPROCITY PROVISION IS SUBJECT TO STRICT SCRUTINY.

Appellees and *amici* challenge appellant's reliance on the recent reciprocity cases. Asserting that these cases do not consider reciprocity arrangements to be always facially discriminatory, they seek to distinguish them because they impose "absolute bars."

Appellant cited these cases for the proposition that forced reciprocity arrangements—i.e., reciprocity "invitations" backed up by threats to exclude the outsider from the market—face strict scrutiny, and are subject to the least drastic alternative test. Both *Sporhase v. Nebraska* and *Great A&P Tea Co. v. Cottrell*, 424 U.S. 366 (1976) support that. See *Sporhase*, 458 U.S. at 957; *A&P*, 424 U.S. at 377. *A&P* even raised the possibility that *voluntary* reciprocity agreement might excessively burden commerce. 424 U.S. at 379 n. 13.

The fact that New Energy is taxed, and Louisiana milk was barred is irrelevant, as noted in appellant's brief, pp. 24-26. Even the presence of a market participation element does not save a mandatory reciprocity agreement, even where unlike here, the reason for the reciprocity—protection of a state's scarce water supply—is fully accepted. *Sporhase v. Nebraska*.

Ohio's reciprocity statute has excluded New Energy from the Ohio market. *Amici* Illinois, Idaho as well as several other states have such statutes and Missouri is adopting one. Should the Ohio statute be upheld, reciprocity statutes currently not being enforced, will be, and more states may adopt such laws. New Energy and other producers from Indiana and the other 24 states that have no credit will be excluded from Ohio, Illinois, and the other reciprocity states. Moreover, the different tax rates will produce different taxation even among states that give credit. See appellant's Br., pp. 22-23. We will truly have a patchwork of most-favored-nation enclaves, precisely what the Framers tried to prevent.

### III. A. IMPROVING HEALTH WAS NOT THE PURPOSE OF THE RECIPROCITY PROVISION.

Despite appellees' continual reiteration that the purpose of the sales tax credit was to protect the health of Ohio's residents, they cannot escape the fact that despite their arguments, no court has so found.<sup>8</sup> See Appellant's Br. 28, 33-34. The evidence as to retaliation and pressure is undisputed.

South Point argues that the testimony of New Jersey's president referred only to "his belief that South Point lobbied to put pressure on Indiana to enact an ethanol tax credit." South Point Br. 26; emphasis in original. But New Energy's president testified to what South Point General Manager Lauren Hill "had told me the reasons why they were lobbying so heavily for it so they would put pressure on Indiana." J.A. 123 (emphasis added). This is not just the witness' belief. Moreover, this testimony was not only never contradicted, it was not even challenged when Mr. Hill testified. When asked whether he had supported the reciprocity legislation to "put pressure on Indiana to pass legislation," he did not deny it, but said vaguely that he was interested in providing an "incentive to all states." In practice, however, this meant only Indiana, for, as noted in appellant's brief, all the other neighboring states already had tax credits and only Indiana had repealed its credit.<sup>9</sup>

<sup>8</sup> The trial court did accept Ohio's Proposed Finding that it was "conceivable" that the reciprocity provision had several purposes, and appellant stands corrected. See appellant's Br. p. 13. But as stressed in appellant's brief, the trial court pointedly refused to find that health was in fact one of the legislative purposes and found only that "promoting domestic industry and to affect the policies of other states to grant reciprocal tax credits" were the legislative purposes. J.St.A. 63a (emphasis in original).

<sup>9</sup> South Point Ethanol asserts at one point that the Indiana tax was repealed "in anticipation of New Energy's entry into the market," replacing the credit with a production incentive. South Point Br. 7. There is no evidence of "anticipation" or other causal link

South Point seems to argue that even a retaliatory tax is permissible, citing *Western and Southern Life Ins. Co. v. State Board of Equalization*, 451 U.S. 648 (1981) ("retaliatory insurance tax"). But that was a Fourteenth Amendment equal protection case, where rational-basis scrutiny applies, not a Commerce Clause case where much more stringent standards govern and where avoiding retaliation is a primary goal. Nevertheless, appellees treat the two constitutional provisions identically throughout. See Ohio Br. 20; South Point Br. 18. And even under the Fourteenth Amendment Justices Stevens and Blackmun deplored "the practice of holding hostages to coerce another sovereign to change its policies." 451 U.S. at 674, which is precisely what Ohio is doing here. Under the Commerce Clause, such hostage-taking is clearly unacceptable. See *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 524 (1935) and *A&P*.<sup>10</sup>

between Indiana's tax credit repeal and New Energy's entry. New Energy tried to introduce evidence on this matter (which would have shown other reasons) but the trial court refused to allow such testimony. J.A. 69; Transcript of Mar. 24, 1985 Hg. at 38.

The National Governor's Association, *et al.* brief describes the Indiana tax credit as reciprocal. Brief of the Nat'l Governor's Ass'n *et al.*, pp. 4, 9. This is incorrect. See J.A. 67-68.

<sup>10</sup> South Point also challenges appellant's claim that if health had really been the primary purpose, there would not be so many exceptions. In response to the exception for ethanol made from sugar, South Point stresses that most ethanol is made from corn, apparently implying that the exclusions are unimportant. But Brazilian ethanol is barred and Brazilian producers were originally in the Ohio market. Transcript of March 1, 1985 Hg. at 62 (bar to further Brazilian imports because of Ohio Rev. Code § 5735.145); J.A. 101, 120. And there were many other exclusions, see Appellant's Br. 33-34, including at least three major ethanol sources in Iowa and Illinois that use gas instead of coal to fire their plant, see J.A. 122. Nor does South Point explain why Ohio excludes ethanol from states that provide other kinds of incentives, like Indiana, when that incentive successfully promotes the use of ethanol. Compare *Westinghouse Elec. Corp. v. Tully*, 406 U.S. at 405 (limitation inconsistent with purported intent).

## B. NEW ENERGY HAS SUFFICIENTLY DEMONSTRATED THE BURDEN ON COMMERCE.

Appellees revert to the argument that (a) New Energy must demonstrate a burden on commerce; and (b) the indisputable heavy burden on New Energy is not enough. Since the statute is facially discriminatory, the issue of burden does not even arise.<sup>11</sup> But even if that issue were relevant, appellees make no effort even to distinguish the many cases cited by appellant in which only one out-of-stater was shown to be affected. See Appellant's Br. 21-22. Moreover, no case has required an actuarial demonstration that the flow of commerce was actually diminished. There was no evidence in *Hunt v. Washington Apple Advertising Comm'n*, 432 U.S. 333 (1977) that fewer apples had come into North Carolina from out-of-state sources, nor in *Lewis v. BT Inv. Mgrs, Inc.*, 447 U.S. 27 (1980) that there were fewer investment entity transactions because BT Investment managers were excluded. See 447 U.S. at 39-40 (1980) (many other out-of-state investment enterprises available to enter the local markets.)<sup>12</sup>

Furthermore, no case has required such precise tracing of who obtained the business lost by the excluded entity,

<sup>11</sup> On its face, the reciprocity provision: (1) treats Ohio-produced ethanol differently from ethanol produced elsewhere; (2) treats ethanol produced in states that give a credit differently from ethanol produced in states that do not. Compare *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. at 333 (discrimination "between two kinds of interstate transactions" forbidden).

<sup>12</sup> Ohio also suggests that "if New Energy ceases doing business in Ohio . . . New Energy has not even established that the Ohio producer has the capacity to fill any void in the market." Ohio Br. 23. But South Point itself implicitly conceded it had such capacity—its sales in Indiana had fallen sharply, when New Energy began operations. J.A. 132-33, which was, of course, the reason it lobbied Ohio to force reinstatement of the Indiana tax credit in order to try to recapture and possibly expand its share of the Indiana market.

for that would be an impossible task. Thus, in *Armco, Inc. v. Hardesty*, 467 U.S. 638 (1984), the Court struck down a tax because of an exemption granted only local manufacturers, even though the burden was only "hypothetical" and depended on "another state lev[ying] a corresponding tax." The Court refused to require Armco "to prove actual discriminatory impact." 467 U.S. at 644.

Finally, the test of *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970), on which appellees purport to rely, provides that "the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted with a lesser impact on interstate activities." 397 U.S. at 142. (emphasis added) (Both appellees omit the italicized portion of this sentence in their references to the *Pike* test. See Ohio Br. pp. 16, 21, 27, 28; South Point Br. pp. 19, 27, 28, 29, 31.) Even if, contrary to the trial court's finding, promoting health through a cleaner environment were indeed the purpose of Ohio's reciprocity provision, Ohio could obviously achieve that goal by encouraging ethanol to come in to displace gasoline, no matter where or how the ethanol was produced, and regardless of how the foreign ethanol's home state treated Ohio ethanol.

## CONCLUSION

The decision of the Ohio Supreme Court upholding Ohio Rev. Code 5735.145(B) should be reversed.

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March 21, 1988

## APPENDIX

ALCOHOL OUTLOOK, p. 6

March, 1988

November 1987 Gasoline & Ethanol-Blend Utilization

	Total (000)	Unleaded (000)	Unl. Prem. (000)	Ethanol/ Gas (000)	Blends % Mkt.	Yr. Ago % Change
PAD-I	3,240,250	1,537,563	966,438	39,919	1.23	-36%
CT*	131,600	61,089	46,942		ERR	ERR
ME	49,041	27,527	8,518			
MA	199,799	101,158	66,513			
NH	41,035	21,218	11,584			
RI*	30,900	14,060	10,166			
VT*	212,995	113,825	52,099			
DE	26,610	14,590	6,613			
DC	17,800	6,194	9,804			
MD	170,003	78,592	58,889	100*		-93%
NJ*	251,200	121,681	89,729			
NY*	481,504	215,040	183,020			
PA	341,219	164,843	86,499	605*	0.18	-87%
FL*	318,211	140,936	104,023	10,655*	3.35	32%
GA	274,610	127,254	70,437	1,000*	0.36	-66%
NC	264,440	122,462	57,251	2,100*	0.79	-69%
SC	123,967	59,169	24,967	4,586	3.70	206%
VA	227,495	110,017	62,061	20,423	8.98	-23%
WV*	77,821	37,907	17,323	450*	0.58	-55%
PAD-II	2,777,376	1,505,881	376,400	469,895	16.92	15%
IL	351,815	204,651	61,357	119,675*	34.02	6%
IN*	259,611	135,335	35,593	51,870*	19.98	-13%
IA	104,427	56,150	6,015	31,638	30.30	14%
KS	99,665	55,204	6,329	8,057	8.08	-47%
KY	207,045	96,835	35,964	58,199	28.11	-10%
MI	353,091	209,030	49,186	39,959	11.32	18%
MN*	161,800	96,740	11,779	16,666*	10.30	-20%
MO	209,507	110,850	25,748	3,500*	1.67	
NE	58,005	30,632	2,181	18,622	32.10	25%
ND	28,657	12,835	963	2,755	9.61	-65%
OH*	412,100	232,424	75,546	77,300*	18.76	-3%
OK	130,626	65,927	8,216	4,000*	3.06	-64%
SD*	35,655	16,637	1,366	5,290*	14.84	-1%
TN	201,707	89,618	40,079	31,679	15.71	-17%
WI	163,665	93,011	16,170	685	0.42	37%
PAD-III	1,365,886	663,029	254,026	87,236	6.39	-8%
AL	164,809	72,879	35,319	34,780	21.10	50%
AR	161,710	73,578	24,839	311*	0.19	522%

## 2a

	Total (000)	Unleaded (000)	Unl. Prem. (000)	Ethanol/ Gas (000)	Blends % Mkt.	Yr. Ago % Change
LA	157,928	79,375	41,440	9,426	5.97	-69%
MS	99,036	44,715	18,312	405*		
NM	67,010	35,931	3,987	8,167	12.19	49%
TX	715,393	356,552	130,130	34,147	4.77	-6%
PAD-IV	282,562	139,794	18,988	6,682	2.36	80%
CO	117,594	62,995	10,360	3,048	2.59	22%
ID	46,000	18,731	1,366	3,229	7.02	375%
MT	32,803	15,194	666	130	0.40	-69%
UT*	62,100	31,286	5,496	250*	0.40	150%
WY*	24,065	11,587	1,100	25*	0.10	150%
PAD-V	1,565,181	785,144	305,512	45,470	2.91	43%
AK	17,301	8,701	1,062	48		
AZ*	128,605	67,505	14,841	102*		
CA*	1,050,605	543,058	239,643	32,996*	3.14	55%
HI	26,123	15,598	5,653			
NV	56,335	28,675	6,428	7,520		
OR	126,946	54,561	14,599	45*	0.04	50%
WA	176,567	75,747	24,349	4,807	2.72	-30%
U.S. TOTALS	9,231,255	4,631,410	1,921,364	649,202	7.03	8%

\*Projected by Information Resources Incorporated

Gasoline and Ethanol/Gasoline Blend Figures are in U.S. Gallons.

Information for this chart was compiled by DOT and IRI.

IN THE  
**Supreme Court of the United States**

OCTOBER TERM, 1987

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NEW ENERGY COMPANY OF INDIANA,  
*Appellant,*

v.

JOANNE LIMBACH,  
TAX COMMISSIONER OF OHIO, MARY ELLEN WITHROW,  
TREASURER OF OHIO, AND SOUTH POINT ETHANOL,  
*Appellees.*

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On Appeal from the Supreme Court of Ohio

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**BRIEF OF THE  
NATIONAL GOVERNORS' ASSOCIATION,  
INTERNATIONAL CITY MANAGEMENT ASSOCIATION,  
NATIONAL CONFERENCE OF STATE LEGISLATURES,  
NATIONAL ASSOCIATION OF COUNTIES,  
COUNCIL OF STATE GOVERNMENTS,  
U.S. CONFERENCE OF MAYORS, AND  
NATIONAL LEAGUE OF CITIES  
AS AMICI CURIAE IN SUPPORT OF APPELLEES**

---

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### **QUESTION PRESENTED**

Whether Ohio's credit against its fuel sales tax for gasohol—which applies only to fuel containing ethanol produced in Ohio or in other States providing a reciprocal tax credit for ethanol produced in Ohio—is valid under the Commerce Clause.

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IN THE  
**Supreme Court of the United States**

OCTOBER TERM, 1987

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No. 87-654

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NEW ENERGY COMPANY OF INDIANA,  
*Appellant,*

v.

JOANNE LIMBACH,  
TAX COMMISSIONER OF OHIO, MARY ELLEN WITHROW,  
TREASURER OF OHIO, AND SOUTH POINT ETHANOL,  
*Appellees.*

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On Appeal from the Supreme Court of Ohio

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**BRIEF OF THE  
NATIONAL GOVERNORS' ASSOCIATION,  
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NATIONAL CONFERENCE OF STATE LEGISLATURES,  
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COUNCIL OF STATE GOVERNMENTS,  
U.S. CONFERENCE OF MAYORS, AND  
NATIONAL LEAGUE OF CITIES  
AS *AMICI CURIAE* IN SUPPORT OF APPELLEES**

---

**INTEREST OF THE *AMICI CURIAE***

The *amici*, organizations whose members include state, county, and municipal governments and officials throughout the United States, have a compelling interest in legal issues that affect state and local governments.

This case presents a Commerce Clause challenge to an Ohio statute that provides a tax credit to fuel dealers who sell gasohol, which is gasoline mixed with ethanol. Ethanol is an alternative to lead, which is a serious pollutant, as an additive to petroleum products. The credit is available for ethanol produced in Ohio or in any other State that provides a similar fuel tax credit for ethanol produced in Ohio.

Appellant New Energy Company of Indiana ("New Energy") invokes the dormant Commerce Clause as a basis for invalidating Ohio's attempt to encourage a substitute for lead in order to improve the environment of the State's citizens. New Energy argues that the Ohio law burdens and discriminates against interstate commerce by placing some interstate businesses (specifically its own) at a competitive disadvantage.

The Supreme Court of Ohio rejected appellant's claim that the tax credit violates the Commerce Clause. In upholding the reciprocity provision of the Ohio statute, the court concluded that "[i]t does not give an advantage solely to Ohio producers, and does not interfere with the flow of ethanol into Ohio by out-of-state suppliers" (J.S. App. 7a). *Amici* submit that the court's opinion strikes the proper balance between the Commerce Clause's prescription against oppressive burdens upon interstate commerce and the State's power to regulate even-handedly to effectuate a legitimate local public purpose.

The dormant Commerce Clause interdicts state legislation that discriminates against or burdens interstate commerce. It has been invoked to invalidate state taxes that fall more heavily on out-of-state businesses. The challenge here, by contrast, is to an Ohio law that imposes no barrier to the flow of commerce into the State and no tax on the importation of ethanol from outside the State. On the contrary, Ohio offers a tax credit to retailers of fuel containing ethanol that is produced

within the State or in other States that afford a reciprocal tax credit for Ohio-produced ethanol. The Ohio tax credit is comparable to a credit against a use tax for sales tax that has been paid, which is provided on a reciprocal basis by most States (*see Williams v. Vermont*, 472 U.S. 14, 21-22 (1985)), and whose validity has not been questioned under the Commerce Clause.

The Ohio tax credit at issue here is a subsidy designed to further the State's interest in a clean environment. It seeks to effectuate that purpose in two ways: by promoting the local production of ethanol to replace lead in motor fuel and by encouraging other States to provide similar incentives to the same end. The statute is an example of the kind of creative experiment that is made possible by the separate sovereign existence of the States. This Court has held that the Commerce Clause does not obligate a State that provides a subsidy to foster commerce to extend that subsidy to out-of-state concerns. *E.g., Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794 (1976).

In our view, the Commerce Clause should not be invoked to preserve the profit potential of a single business engaged in interstate commerce at the expense of Ohio's effort to cleanse its environment for the benefit of the health and safety of its citizens. The Commerce Clause protects interstate commerce, not particular interstate businesses.

*Amici* submit that the decision of the Ohio Supreme Court is correct. Because this Court's decision will have a direct effect on matters of prime importance to *amici* and their members, *amici* submit this brief to assist the Court in its resolution of the case.<sup>1</sup>

<sup>1</sup> Pursuant to Rule 36 of the Rules of the Court, the parties have consented to the filing of this brief. Their letters of consent have been filed with the Clerk of the Court.

## STATEMENT OF THE CASE

*Amici* agree with the statements of the case set forth in the briefs of appellees Limbach and South Point Ethanol, but wish to emphasize the following points.

As originally enacted in 1981, the Ohio statute granted motor vehicle fuel dealers a credit against sales tax with respect to the sale of gasohol, which is gasoline containing not more than ten percent by volume of ethanol. Effective January 1, 1985, Ohio amended its statute to provide that fuel eligible for the credit shall not contain ethanol produced outside Ohio unless the producing State "also grants an exemption, credit or refund from such state's motor vehicle fuel excise tax or sales tax for similar fuel containing ethanol produced in Ohio . . . ." Ohio Rev. Code Ann. § 5735.145(B) (Page 1984).

More than 30 States allow sales tax credits for gasohol (J.S. App. 45a). In addition to Ohio, nine States, including the neighboring States of Illinois, Tennessee, and Kentucky, provide that credit only to producers in States that have reciprocal tax credit provisions. Indeed, Indiana, where appellant New Energy operates, had a reciprocal tax credit which was repealed shortly after the State adopted a direct subsidy program in 1984 (J.S. App. 8a, 45a).

Ethanol and gasohol sold in Ohio are obtained primarily through interstate commerce from Illinois and Tennessee (J.S. App. 9a). The record establishes that if New Energy's sales to Ohio dealers are reduced, the primary beneficiaries would be Illinois and Tennessee producers of ethanol (J.S. App. 46a). As the president and chief executive officer of New Energy acknowledged, an Illinois producer (Archer Daniels Midland) would be fully capable of supplying any Ohio markets that New Energy might relinquish (J.A. 79).

## SUMMARY OF ARGUMENT

A. To promote a cleaner environment by reducing the use of lead-based pollutants, Ohio grants a special sales tax credit to fuel dealers who sell gasohol, a mixture of gasoline and ethanol. The credit is available for ethanol produced either in Ohio or in other States that provide a similar tax credit for ethanol produced in Ohio.

The Ohio statute satisfies the standard established by this Court in *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970), for valid state action under the Commerce Clause. Here, any burden imposed on interstate commerce by the reciprocal tax credit is not excessive in relation to the local benefits that it seeks to achieve. Indeed, the Ohio statute does not prohibit the interstate flow of ethanol but simply conditions out-of-state producers' eligibility for a tax credit on their States' granting Ohio producers comparable treatment. The net effect of this reciprocity provision is disadvantageous to a single Indiana producer, appellant New Energy, because Indiana has repealed its tax credit in favor of a direct subsidy program. But even after the enactment of the Ohio reciprocal tax credit, there continues to be a thriving interstate market for ethanol sold in Ohio, principally from Illinois and Tennessee producers. This Court has held that "interstate commerce is not subjected to an impermissible burden simply because an otherwise valid regulation causes some business to shift from one interstate supplier to another." *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 127 (1978). "[T]he Commerce Clause protects the interstate market, not particular interstate firms, from prohibitive or burdensome regulations" (*id.* at 127-128).

Moreover, the Ohio legislature was amply justified in enacting the reciprocal tax credit to encourage the use of ethanol in surrounding States as a means of clean-

ing the local environment. In these circumstances, the Ohio statute satisfies the *Pike v. Bruce Church* test because it "regulates evenhandedly to effectuate a legitimate local public interest," "its effects on interstate commerce are only incidental," and the burden imposed on interstate commerce is not "excessive in relation to the putative local benefits" (397 U.S. at 142).

B. The Ohio tax credit is not limited to domestic ethanol producers at the expense of out-of-state producers. Indeed, the continued presence of Illinois and Tennessee producers in the Ohio market confirms that Ohio has not erected a discriminatory trade barrier that might implicate the Commerce Clause, and there is no basis for New Energy's speculative allegation that the effect of the Ohio tax statute would cause Ohio-produced ethanol to acquire a larger share of the Ohio market. "The fact that the burden of a state regulation falls on some interstate companies does not, by itself, establish a claim of discrimination against interstate commerce." *Exxon*, 437 U.S. at 126 (footnote omitted). The cases upon which New Energy relies are therefore distinguishable because they all involve absolute barriers to interstate commerce.

In practical effect, the Ohio reciprocal tax credit is comparable to the credits against use taxes for sales taxes or against income taxes paid to another State. See *Williams v. Vermont*, 472 U.S. 14, 21-22 (1985). It has never been suggested that such reciprocity violates the Commerce Clause.

C. The Court has held that "[n]othing in the purposes animating the Commerce Clause prohibits a State . . . from participating in the market and exercising the right to favor its own citizens over others." *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 810 (1976) (footnote omitted). That case acknowledged the State's free-

dom from Commerce Clause restraints in providing a subsidy for commerce that was created by the State. Since that decision, the market participant immunity has been recognized in the context of the sale of commodities and in employment, spheres of commerce in which private parties also operate. This case falls squarely within the original doctrine, for it is undisputed that commerce in ethanol owes its existence to the federal and state tax credits that are provided to gasoline dealers.

The Ohio tax credit is indistinguishable from the subsidy upheld in *Alexandria Scrap*. "Both tax exemptions and tax deductibility are a form of subsidy that is administered through the tax system." *Regan v. Taxation With Representation of Washington*, 461 U.S. 540, 544 (1983); see also *Arkansas Writers Project, Inc. v. Ragland*, 107 S.Ct. 1722, 1730-1732 (1987) (Scalia, J., dissenting). The fact that Ohio did not exercise its prerogative at the outset to limit the tax credit to ethanol from States offering a similar tax credit to Ohio-produced ethanol does not limit Ohio's power to impose that requirement now. See *Alexandria Scrap*, 426 U.S. at 809. Nor is the reciprocity requirement invalid as an initial matter, for the tax credit, like the subsidy in *Alexandria Scrap*, is largesse that Ohio is not constitutionally required to extend to all out-of-state producers.

## ARGUMENT

### THE OHIO TAX CREDIT PROVISION IS VALID UNDER THE COMMERCE CLAUSE.

#### A. The Burden Imposed On Interstate Commerce By The Ohio Tax Credit Is Not Excessive In Relation To Local Benefits.

In recent years, the Court has generally used the balancing test enunciated in *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970), to determine whether a state law burdens interstate commerce in violation of the Commerce Clause. As the Court there stated (*id.* at 142):

Where [a] statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.

See *Brown-Forman Distillers Corp. v. New York State Liquor Authority*, 106 S.Ct. 2080, 2084 (1986); *Arkansas Electric Cooperative Corp. v. Arkansas Public Service Comm'n*, 461 U.S. 375, 393-394 (1983). The Ohio reciprocal tax credit clearly satisfies this standard and therefore does not impermissibly burden interstate commerce.<sup>2</sup>

<sup>2</sup> *Amici* have previously argued that the "balancing" component of the *Pike v. Bruce Church* standard that measures whether the burden on interstate commerce imposed by a state statute "is clearly excessive in relation to the putative local benefits" is inappropriate and should be discarded. See Brief of the National Governors' Association, *et al.*, as *amici curiae* in *Transcontinental Gas Pipe Line Corp. v. State Oil & Gas Board of Mississippi*, No. 84-1076. The defects inherent in the *Pike v. Bruce Church* stand-

More than 30 States allow tax credits for gasohol (J.S. App. 45a). As the Supreme Court of Ohio found, most of the States near Ohio have reciprocal tax credit provisions (J.S. App. 8a-9a). Indeed, Indiana replaced its reciprocal tax credit with a direct subsidy program. As a result of that action by the Indiana legislature, New Energy, an Indiana ethanol producer, has become ineligible for the Ohio tax credit.<sup>3</sup> But a burden on New Energy is not equivalent to a burden on interstate commerce. As the Ohio Supreme Court observed, "the bulk of ethanol and gasohol sold in Ohio is obtained primarily through interstate commerce, whereby ethanol is shipped into Ohio from Illinois and Tennessee. Thus, New En-

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ard were identified by Justice Scalia in his concurring opinion in *CTS Corp. v. Dynamics Corp. of America*, 107 S.Ct. 1637, 1652-1653 (1987). Undertaking such an analysis of the potential excessiveness of state action in meeting a legitimate state problem (akin to a determination whether the penalty fits the crime) is a policymaking function that belongs more appropriately to the legislative and executive branches than to the courts. Although *amici* believe that the Court's standard for Commerce Clause analysis should be reconsidered, we submit that the Ohio statute unquestionably satisfies the *Pike v. Bruce Church* test.

<sup>3</sup> Indiana replaced its reciprocal tax credit with a direct subsidy for in-state producers like New Energy. Analyzed simply in terms of the effect on out-of-state businesses, a reciprocal credit is far less burdensome than a subsidy limited to in-state producers. Yet this Court has never held that subsidies limited to in-state concerns violate the Commerce Clause. See generally *Arkansas Writers' Project, Inc. v. Ragland*, 107 S.Ct. 1722, 1730-1732 (1987) (Scalia, J., dissenting). Such subsidies frequently represent the essential legislative prerogative to advance the interests of the citizens and businesses in the State. *Amici* submit that there is nothing inherently burdensome about an economic measure labelled a tax credit rather than a subsidy, particularly when it is not limited to in-state producers. The mere fact that the eligibility for the tax credit is conditioned on reciprocity does not create an unconstitutional burden. Such a requirement can be viewed as analogous to a subsidy available to certain businesses but not to others. See also Part C, *infra*, at 16-19.

ergy's inability to compete in the Ohio market will not affect the flow of ethanol through interstate commerce into Ohio gas stations" (J.S. App. 9a). In fact, if New Energy's sales in Ohio are reduced, "the primary beneficiaries would be Illinois and Tennessee producers of ethanol" (*id.* at 46a).

This Court has previously rejected the essence of New Energy's claim of burdensome state regulation. In *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117 (1978), the Court considered a statute that excluded certain out-of-state producers from the retail gasoline market. The Court noted (and the findings confirm that the same is true in this case) that "there is no reason to assume that their share of the entire supply will not be promptly replaced by other interstate refiners" (*id.* at 127). The *Exxon* Court held that "interstate commerce is not subjected to an impermissible burden simply because an otherwise valid regulation causes some business to shift from one interstate supplier to another" (*ibid.*). "[T]he [Commerce] Clause protects the interstate market, not particular interstate firms, from prohibitive or burdensome regulations" (*id.* at 127-128).

As in *Exxon*, the Ohio statute does not implicate the free trade and anti-protectionist values of the Commerce Clause. The tax credit is available to both in-state and out-of-state producers, and the record establishes the continued existence of a thriving interstate market for ethanol sold in Ohio after the enactment of the reciprocal tax credit.

The record also establishes that the tax credit serves a legitimate local purpose. Ethanol is an effective substitute for lead, which is a dangerous atmospheric pollutant. Both the federal government and the States have chosen tax credits as the best means of encouraging the use of ethanol (J.S. App. 39a). In these circumstances,

the Ohio legislature was amply justified in enacting the reciprocal tax credit provision to encourage the use of ethanol in surrounding States as a means of cleansing the local environment.<sup>4</sup>

The mere fact that the Ohio legislation may influence the tax policy of other States does not render the statute illegitimate. As the Court recognized in *United States Steel Corp. v. Multistate Tax Comm'n*, 434 U.S. 452, 478 (1978), "any time a State adopts a fiscal or administrative policy that affects the programs of a sister State, pressure to modify those programs may result. Unless that pressure transgresses the bounds of the Commerce Clause or the Privileges and Immunities Clause of Art. IV, § 2, see, e.g., *Austin v. New Hampshire*, 420 U.S. 656 (1975), it is not clear how our federal structure is implicated."

Finally, even assuming that the Ohio legislature sought, in part, to protect the Ohio ethanol industry represented by appellee South Point Ethanol from competitive disadvantage (see J.S. App. 63a), that purpose would not invalidate the reciprocal tax credit under the Commerce Clause. Cf. *Henneford v. Silas Mason Co.*, 300 U.S. 577, 581 (1937). In a comparable Equal Protection Clause context, this Court upheld a California tax on insurance companies licensed in States that imposed a higher rate of tax on California insurance companies than California would otherwise impose on those States' insurers doing business in California. See *Western & Southern Life Insurance Co. v. Board of Equalization*, 451 U.S. 648 (1981). In so ruling, the Court, citing

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<sup>4</sup> Whether the Ohio legislation constitutes a sensible means of achieving a clean environment is not at issue. "[I]t is up to legislatures, not courts, to decide on the wisdom and utility of legislation." *Ferguson v. Skrupa*, 372 U.S. 726, 729 (1963). This Court's review under the Commerce Clause is confined to the legitimacy of the purpose.

*Pike v. Bruce Church, Inc.*, 397 U.S. at 143, endorsed the legitimacy of a State's efforts, either through its tax structure or similar reciprocal provisions, to "protect and enhance the reputation" of a domestic industry so that it might compete more effectively in the interstate market (*id.* at 671).

The Ohio tax credit does not go further in protecting in-state commerce. It does not give the in-state producer a competitive advantage over out-of-state producers, such as those from the neighboring States of Illinois and Tennessee.<sup>5</sup> In fact, the in-state producer, appellee South Point, is not the principal beneficiary of the Ohio statute because it does not have the capacity to acquire New Energy's share of the Ohio market (J.A. 28, 76-80, 129). Thus, New Energy's competition is not South Point. Rather, it is ethanol producers in Illinois and Tennessee and gasoline produced without ethanol.

Indeed, it is plain that the Ohio reciprocity provision, standing alone, does not operate to the detriment of New Energy. It is the combination of the reciprocity provision and Indiana's failure to provide reciprocal treatment that makes New Energy ineligible for the Ohio tax credit. Indiana, of course, is free to decide not to offer a reciprocal tax credit for ethanol produced in Ohio or other States. But the Commerce Clause provides no basis for exalting that decision over Ohio's and limiting Ohio's tax and environmental policy choices.

<sup>5</sup> Appellee South Point Ethanol's support of the Ohio reciprocal tax credit is not a basis for invalidating it under the Commerce Clause as protectionist in purpose. This Court has stated in the context of an equal protection challenge that it will not invalidate a state statute "merely because some legislators sought to obtain votes for the measure on the basis of its beneficial side effects on state industry." *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 463 n.7 (1981). In the same case, the Court applied this rule to reject a Commerce Clause challenge. See *id.* at 471 n.15.

## B. The Ohio Tax Credit Does Not Discriminate Against Interstate Commerce.

The Ohio tax credit does not affront the core purpose of the Commerce Clause, which is to prevent States from discriminating against interstate commerce by imposing absolute trade barriers or by oppressive taxes. Thus, the Court has struck down state statutes that prohibited the importation of commodities from outside the State (*Philadelphia v. New Jersey*, 437 U.S. 617 (1978)), prohibited out-of-state banks from owning certain interests within the State (*Lewis v. BT Investment Managers, Inc.*, 447 U.S. 27 (1980)), or imposed a higher tax on out-of-state interests compared to in-state interests. *American Trucking Ass'ns, Inc. v. Scheiner*, 107 S.Ct. 2829 (1987); *Tyler Pipe Industries, Inc. v. Washington Dept. of Revenue*, 107 S.Ct. 2810 (1987); *Bacchus Imports, Ltd. v. Diaz*, 468 U.S. 263 (1984); *Armco Inc. v. Hardesty*, 467 U.S. 638 (1984); *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388 (1984); *Maryland v. Louisiana*, 451 U.S. 725 (1981); *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318 (1977).

The Ohio reciprocal tax credit at issue in this case does not fit within any of the prohibited categories under this Court's Commerce Clause cases.<sup>6</sup> The Ohio tax credit

<sup>6</sup> In recent years, the Court has analyzed some claims of discrimination under the Commerce Clause by applying a test of "internal consistency." See *American Trucking Ass'ns*, 107 S.Ct. at 2840-2842; *Tyler Pipe Indus.*, 107 S.Ct. at 2820; *Armco*, 467 U.S. at 644-645. This test was first employed in the context of apportionment in *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 163 (1983). Amici have previously argued that the internal consistency test has no application to a claim of discriminatory taxation under the Commerce Clause. See Brief of the National Governors' Association, *et al.*, as amici curiae in *Tyler Pipe Industries, Inc. v. Washington Dept. of Revenue*, Nos. 85-1963,

is not limited to domestic ethanol producers at the expense of out-of-state producers. Both Ohio producers and out-of-state producers are subject to the same treatment. *Cf. Henneford*, 300 U.S. at 581-582. Nor does Ohio bar entry of out-of-state producers to its markets or prohibit the interstate flow of ethanol. Indeed, the continued presence of Illinois and Tennessee producers in the Ohio market confirms that Ohio has not erected any trade barrier that might implicate the Commerce Clause.<sup>7</sup> "The fact that the burden of a state regulation falls on some interstate companies does not, by itself, establish a claim of discrimination against interstate commerce." *Exxon*, 437 U.S. at 126 (footnote omitted).

In practical effect, the Ohio reciprocal tax credit is comparable to the credits accorded by 47 States and the District of Columbia against their own use taxes for sales taxes paid to another State.<sup>8</sup> See *Williams v. Vermont*, 472 U.S. 14, 21-22 (1985). It has never been suggested that the requirement of reciprocity violates the Commerce Clause. Quite to the contrary, reciprocity in that comparable context enhances, rather than impedes, interstate commerce.

85-2006. We also suggest that tax credits may not present the same Commerce Clause concerns as taxes. See n.3, *supra*.

Nevertheless, it is clear that a reciprocal tax credit will always pass the internal consistency test. Under that test, "the [tax] must be such that, if applied by every jurisdiction, there would be no impermissible interference with free trade." *Armco*, 467 U.S. at 644, quoting *Container Corp.*, 463 U.S. at 163. If every State offered the same tax credit as Ohio, no claim of discrimination could possibly arise.

<sup>7</sup> There is no basis in the record for New Energy's speculative allegation (Brief 24) that the effect of the Ohio tax credit would cause Ohio producers to acquire a larger share of the Ohio market. *Cf. Exxon Corp. v. Governor of Maryland*, 437 U.S. at 126-127 n.16.

<sup>8</sup> In like fashion, it is common for a State to offer income tax credits to residents of other States on the condition of reciprocal tax treatment of its residents by the other States.

Absent the creation of trade barriers by the Ohio reciprocal tax credit, appellant's reliance upon *Great Atlantic & Pacific Tea Co. v. Cottrell*, 424 U.S. 366 (1976), and *Sporhase v. Nebraska ex rel. Douglas*, 458 U.S. 941 (1982), is misplaced. In *Great Atlantic & Pacific Tea Co.*, the Court, on the authority of *Dean Milk Co. v. Madison*, 340 U.S. 349 (1951), struck down a Mississippi regulation that provided that milk from another State could be sold in Mississippi only if the other State accepted milk processed in Mississippi on a reciprocal basis. Finding that there were no legitimate state interests for the regulation, the Court concluded that "the barrier of the reciprocity clause to sales of out-of-state milk in Mississippi has . . . 'in practical effect exclude[d] from distribution in [Mississippi] wholesome milk produced . . . in [Louisiana]'" (424 U.S. at 375) (citation omitted). A careful reading of the Court's opinion in *Great Atlantic & Pacific Tea Co.* confirms that the critical basis for the ruling was the absolute trade barrier erected by Mississippi. As the Court stated, "Mississippi is not privileged under the Commerce Clause to force its own judgments as to an adequate level of milk sanitation on Louisiana at the pain of an absolute ban on the interstate flow of commerce in milk" (*id.* at 380) (emphasis supplied). Here, in marked contrast, Ohio has not barred from its markets any ethanol produced outside the State. See also *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511 (1935).

*Sporhase* is likewise distinguishable. There, the Court invalidated a Nebraska statute that absolutely forbade export of ground water to another State unless that State granted reciprocal rights to transport its ground water to Nebraska. Because Colorado prohibited the export of its ground water, the reciprocity provision operated as "an explicit barrier to commerce between the two States" (458 U.S. at 957). The reciprocity requirement did not significantly advance Nebraska's legitimate conservation and preservation interests and was therefore invalid.

Again, it is plain that the Court's decision turned on the absolute barrier against interstate commerce erected by Nebraska's reciprocity provision. See also *Hughes v. Oklahoma*, 441 U.S. 322 (1979).<sup>9</sup>

In sum, the absence of an absolute trade barrier in this case effectively distinguishes it from *Great Atlantic & Pacific Tea Co.* and *Sporhase*. Because Ohio has extended the tax credit to out-of-state producers of ethanol where their States grant a tax credit to Ohio producers, the statute does not discriminate against interstate commerce.

**C. The Ohio Tax Credit Is Valid Under The Commerce Clause Because Commerce In Ethanol Owes Its Existence To Tax Incentives.**

The Ohio tax credit is not, in any event, subject to Commerce Clause restraints because it is, in practical effect, a subsidy that has created the local and interstate market for ethanol. In *Hughes v. Alexandria Scrap Corp.*, 427 U.S. 794 (1976), this Court considered the constitutionality of a subsidy program enacted by the State of Maryland to rid the State of abandoned automobiles. Five years after the program was adopted, the statute was amended to make it more difficult for out-of-state processors to qualify for the subsidy. The Court rejected a Commerce Clause challenge by an out-of-state

<sup>9</sup> *Hunt v. Washington Apple Advertising Comm'n*, 432 U.S. 333 (1977), upon which appellant relies (Brief 24, 26), is likewise inapposite. There, the Court struck down a North Carolina statute that required all out-of-state apples shipped into North Carolina to be sold under inferior federal grades or under no grades at all. In so holding, the Court observed that the North Carolina statute provided the State's apple industry the very sort of protection against out-of-state competition that the Commerce Clause was designed to prohibit (*id.* at 351-352). Here, on the other hand, it is undisputed that the Ohio reciprocal tax credit does not protect in-state ethanol producers from out-of-state competition but simply conditions the tax credit upon reciprocal treatment of Ohio-produced ethanol.

processor to the amended statute. The Court found "[n]othing in the purposes animating the Commerce Clause" to prohibit the State "from participating in the market and exercising the right to favor its own citizens over others" (*id.* at 810) (footnote omitted). The Court noted that "the commerce affected by the [challenged] amendment appears to have been created, in whole or in substantial part, by the Maryland bounty scheme" (*id.* at 809 n.18), and stated: "We would hesitate to hold that the Commerce Clause forbids state action reducing or eliminating a flow of commerce dependent for its existence upon state subsidy instead of private market forces" (*ibid.*). As Justice Stevens' concurring opinion explained, the Maryland subsidy "created a market that did not previously exist" (427 U.S. at 815) and which the State was not required to create "because the Commerce Clause surely does not impose on the States any obligation to subsidize out-of-state business" (*id.* at 815-816).

By subsidizing, through the tax credit, the production and sale of ethanol, Ohio has become a participant in the ethanol market. Since *Alexandria Scrap*, the Court has extended the State's market-participant immunity from Commerce Clause restrictions to contexts in which the commerce is not unique to the State. Freedom from Commerce Clause restraints has been recognized in the sale of commodities and in employment, commerce in which private parties also engage. In *Reeves, Inc. v. Stake*, 447 U.S. 429 (1980), the Court upheld South Dakota's right to sell state-produced cement only to state residents, noting that "[t]he basic distinction drawn in *Alexandria Scrap* between States as market participants and States as market regulators makes good sense and sound law" (*id.* at 436). In *White v. Massachusetts Council of Construction Employers, Inc.*, 460 U.S. 204 (1983), the Court upheld the requirement of a work force of at least fifty percent city residents on all city-financed

or city-administered construction projects. The Court held that *Alexandria Scrap* and *Reeves* “stand for the proposition that when a state or local government enters the market as a participant it is not subject to the restraints of the Commerce Clause” (*id.* at 208).

This case does not require the Court to explore the limits of the State’s immunity under the Commerce Clause when it acts as a market participant. This case is squarely controlled by *Alexandria Scrap*, for it is undisputed that commerce in ethanol would not exist without federal and state tax credits to gasoline dealers. The president of New Energy himself recognized that “absent those credits and ethanol would not be a viable factor in the market place today” (J.A. 65).

That this case involves a tax credit rather than a subsidy, as in *Alexandria Scrap*, does not serve to distinguish it. “Both tax exemptions and tax deductibility are a form of subsidy that is administered through the tax system.” *Regan v. Taxation With Representation of Washington*, 461 U.S. 540, 544 (1983). As Justice Stevens explained in *Alexandria Scrap*, the Commerce Clause does not “inhibit a State’s power to experiment with different methods of encouraging local industry[, w]hether the encouragement takes the form of a cash subsidy, a tax credit, or a special privilege . . . .” (426 U.S. at 816) (concurring opinion). See also *Arkansas Writers’ Project, Inc. v. Ragland*, 107 S.Ct. 1722, 1730-1732 (1987) (Scalia, J., dissenting).

*Alexandria Scrap* teaches that a State’s subsidy to commerce that it creates need not be exercised in favor of out-of-state businesses on the same terms as local businesses. *Alexandria Scrap* also teaches that the State does not lose the power to differentiate between in-state and out-of-state businesses by failing to make that distinction at the outset. The chronology of enacting a limitation—in that case, five years into the subsidy program—“does

not distinguish the case, for Commerce Clause purposes, from one in which a State offered bounties only to domestic producers from the start” (426 U.S. at 809) (footnote omitted). See also *id.* at 816 (Stevens, J., concurring).

Thus, *Alexandria Scrap* makes clear that Ohio’s requirement of reciprocity as a condition of the ethanol tax credit is valid under the Commerce Clause as a limited subsidy; and the fact that New Energy can no longer take advantage of the credit previously available to it creates no constitutional infirmity. Ohio’s “largesse” (426 U.S. at 809) prior to 1985 in providing an unconditional tax credit for ethanol was more than New Energy was constitutionally entitled to receive in a state-created market. Even the current law, which provides a tax credit to some out-of-state businesses, exceeds the requirements imposed by the Constitution on Ohio as a participant in the ethanol market. *Amici* submit that Ohio’s role in creating the market for ethanol alone provides a basis for upholding the reciprocity requirement at issue in this case.

### CONCLUSION

For the reasons stated, the judgment of the Supreme Court of Ohio should be affirmed.

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IN THE  
**Supreme Court of the United States**

OCTOBER TERM, 1987

NEW ENERGY COMPANY OF INDIANA,  
v. *Appellant,*

JOANNE LIMBACH, TAX COMMISSIONER OF OHIO,  
and SOUTH POINT ETHANOL,  
*Appellees.*

**On Appeal from the Supreme Court of Ohio**

**BRIEF FOR THE  
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AS AMICI CURIAE IN SUPPORT OF APPELLEES**

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IN THE  
**Supreme Court of the United States**

OCTOBER TERM, 1987

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No. 87-654

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NEW ENERGY COMPANY OF INDIANA,  
*Appellant,*

v.

JOANNE LIMBACH, TAX COMMISSIONER OF OHIO,  
and SOUTH POINT ETHANOL,  
*Appellees.*

---

On Appeal from the Supreme Court of Ohio

---

**BRIEF FOR THE  
STATES OF IDAHO, IOWA, KANSAS AND MINNESOTA  
AS AMICI CURIAE IN SUPPORT OF APPELLEES**

---

This brief *amici curiae* is jointly filed by the States of Idaho, Iowa, Kansas and Minnesota, sponsored by their respective Attorneys General, pursuant to Rule 36.4 of the Court.

**STATEMENT OF INTEREST**

The four States that have joined to file this brief have concluded, like the State of Ohio, that the production and use of ethanol as an additive to gasoline is in the public interest. Ethanol, when blended with gasoline, increases the fuel's octane rating, reduces carbon monoxide emissions, and eliminates the atmospheric emissions of lead

associated with lead-based fuel additives. The use of a 90/10 blend of gasoline and ethanol, commonly referred to as "gasohol," thus promotes a cleaner and safer environment. In addition, the use of ethanol as a fuel additive expands agricultural markets in the United States and reduces dependence on foreign oil.

To serve these ends, and to make ethanol commercially viable, the four States that have joined this brief, like more than two dozen others, provide a lower tax rate, a tax exemption or a tax credit against the States' motor vehicle fuel taxes for ethanol that is blended into gasohol.<sup>1</sup> Ohio similarly provides a tax credit for ethanol, and makes that credit available to gasohol that is blended from Ohio-produced ethanol *and* to gasohol that is blended from ethanol produced in other States that also provide a tax credit, exemption or refund for Ohio-produced ethanol. The question presented in this case is whether the reciprocity provision of Ohio Rev. Code § 5735.145(B) violates the Commerce Clause.

Because the four *amici* States share Ohio's public policy of promoting ethanol use, and because these States believe that the Ohio reciprocity provision ably and lawfully serves that goal, the *amici* States have a substantial interest in the outcome of this case.

## INTRODUCTION AND SUMMARY OF ARGUMENT

In *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318, 329 (1977), the Court noted that its Commerce Clause jurisprudence is dependent on a "case-by-case approach":

"On various occasions when called upon to make the delicate adjustments between the national interest in free and open trade and the legitimate interest of the individual States in exercising their taxing powers, the Court has counseled that the result

<sup>1</sup> Idaho Code § 63-2405; Iowa Code § 324.21; Kan. Stat. Ann. § 79-3408; Minn. Stat. § 296.02(7).

turns on the unique characteristics of the statute at issue and the particular circumstances in each case." *Ibid.*

Despite this admonition in favor of careful analysis, appellant New Energy largely ignores "the statute at issue and the particular circumstances in [this] case," and instead bases its argument on what it perceives to be a sweeping and well-established principle against reciprocal legislation. Thus, New Energy contends that "[i]n an unbroken line of decisions, this Court has ruled that mandatory reciprocity laws are facially discriminatory and barred by . . . the Commerce Clause." Appellant's Br. 15. In support of this proposition, New Energy relies on but two decisions—*Great A&P Tea Co. v. Cottrell*, 424 U.S. 366 (1976), and *Sporhase v. Nebraska ex rel. Douglas*, 458 U.S. 941 (1982). We submit this brief to refute New Energy's reciprocity analysis.

As we show, *Great A&P Tea* and *Sporhase* are not controlling here. Neither case established the sweeping principle that New Energy would find banning all reciprocal legislation. To the contrary, in a variety of contexts, including regulations affecting interstate commerce, this Court has upheld reciprocal legislation by which a State invites the voluntary cooperation of its sister States. *E.g.*, *Bode v. Barrett*, 344 U.S. 583, 586 (1953); *Kane v. New Jersey*, 242 U.S. 160, 167-68 (1916).

Indeed, the reasons underlying the Court's decisions in *Great A&P Tea* and *Sporhase* were not that the statutes in those cases contained reciprocity provisions *per se*, but that those statutes, by operation of their reciprocity clauses, were protectionist measures that threatened a total ban on interstate commerce and did not effectively further legitimate local interests. Those evils, however, are not present here.

Ohio Rev. Code § 5735.145(B) neither prohibits nor discriminates against interstate commerce in ethanol.

By its tax credit, Ohio does not seek to assure that Ohio residents only purchase ethanol that was produced in Ohio; nor does Ohio seek an unfair advantage for Ohio-produced ethanol in interstate markets. To the contrary, the record establishes that the Ohio tax credit (together with federal tax credits directed at the same end) is itself responsible for the existence of a meaningful market for ethanol. And, by encouraging its sister States to enact similar tax credit legislation, Ohio Rev. Code § 5735.145(B) serves to promote further interstate commerce in ethanol, thus advancing both legitimate State interests in increased ethanol use and the promotion of local industry, and the national interest in free trade that is served by the Commerce Clause.

### ARGUMENT

#### I. THE DECISIONS OF THIS COURT DO NOT ANNOUNCE A PROHIBITION AGAINST ALL RECIPROCAL LEGISLATION.

Central to appellant New Energy's argument before this Court is its claim that "mandatory reciprocity provisions are 'facially discriminatory' and are subject to 'the strictest scrutiny.'" Appellant's Br. 18.<sup>2</sup> As a re-

<sup>2</sup> Although New Energy frequently refers to "mandatory reciprocity," it nowhere explains what it means by that term or the term's significance. If by the term "mandatory reciprocity" New Energy means reciprocal legislation that is enacted by one State without its Sister States' prior agreement to the reciprocal conditions, then the term, and the legal conclusion that New Energy would draw from it, sweep far too broadly. As we show *infra* at 9-11, reciprocal legislation need not be accepted by another State, either before or after its enactment, in order to pass constitutional muster. See *Great A&P Tea Co.*, 424 U.S. at 379 ("we have not held that acceptance of offered reciprocity is required from other States").

On the other hand, if by "mandatory reciprocity" New Energy means reciprocal legislation that, absent acceptance by a sister State, completely prohibits interstate commerce and thus threatens economic isolation, see *id.* at 368, 379, *amici* can understand and ac-

sult, New Energy argues, Ohio Rev. Code § 5735.145(B) is almost facially invalid, regardless of its actual effects (or lack of effect) on interstate commerce.

A. In support of its proposition concerning reciprocal legislation, New Energy relies on but two decisions—*Great A&P Tea Co. v. Cottrell*, 424 U.S. 366 (1976), and *Sporhase v. Nebraska ex rel. Douglas*, 458 U.S. 941 (1982). In each case the Court held invalid under the Commerce Clause a State law that contained a reciprocity provision. Those cases, however, do not support the sweeping proposition that New Energy asserts. And, those cases are not controlling here.

*Great A&P Tea* struck down a Mississippi statute that allowed milk from another State to be sold in Mississippi only if the other State "accepts Grade A milk and milk products produced and processed in Mississippi on a reciprocal basis." 424 U.S. at 367. In addition to its health-related arguments—which the Court characterized as "border[ing] on the frivolous," *id.* at 375<sup>3</sup>—Mississippi sought to justify its reciprocity requirement as promoting commerce. *Id.* at 378.

The Court rejected Mississippi's argument, but it did not do so on the ground that reciprocity provisions are *per se* unlawful. Instead, the Court expressly "recognized that mutually beneficial objectives may be promoted by voluntary reciprocity agreements." *Id.* at 378. What the Court found objectionable was not that Mississippi's

cept the term. But, as we show, the reciprocity provision found in Ohio Rev. Code § 5735.145(B)—unlike those in *Great A&P Tea Co.* and in *Sporhase*—cannot properly be characterized as that form of reciprocity and therefore is not impermissible. See *infra* at 12-18.

<sup>3</sup> The Court explained: "[E]ven if Louisiana's standards were lower than Mississippi's, the clause permits Louisiana milk to be admitted to Mississippi if Louisiana enters into a reciprocity agreement. The reciprocity clause thus disserves rather than promotes any higher Mississippi milk quality standards." *Id.* at 375-76.

legislation offered a reciprocal arrangement—an arrangement that Louisiana and other States could accept or refuse—but that Mississippi had “use[d] the threat of economic isolation as a weapon to force sister States to enter into [this] reciprocity agreement.” *Id.* at 379. Thus, “the barrier of the reciprocity clause to sales of out-of-state milk in Mississippi . . . ‘in practical effect exclude[d] from distribution in [Mississippi] wholesome milk produced . . . in [Louisiana].’” *Id.* at 375 (quoting *Dean Milk Co. v. Madison*, 340 U.S. 349, 354 (1951)). Such a total bar to interstate commerce was “‘precisely the kind of hinderance to the introduction of milk from other States . . . condemned as an ‘unreasonable clog upon the mobility of commerce.’”’” *Id.* at 381 (quoting *Polar Ice Cream & Creamery Co. v. Andrews*, 375 U.S. 361, 377 (1964)).<sup>4</sup>

<sup>4</sup> The Court also rejected Mississippi’s argument that its reciprocity requirement was a valid response to Louisiana’s “erect[ing] economic barriers to the sale of Mississippi milk in Louisiana under the guise of health and inspection regulations.” *Id.* at 379. The appropriate response, the Court ruled, was not for Mississippi to engage in economic retaliation, but for “Mississippi and its producers [to] pursue their constitutional remedy by suit in state or federal court challenging Louisiana’s actions as violative of the Commerce Clause.” *Id.* at 380.

New Energy points to this portion of *Great A&P Tea* and suggests that Ohio’s only appropriate response to Indiana’s enactment of a direct production subsidy for ethanol (which benefits only New Energy) instead of a tax credit “is a lawsuit, not discriminatory legislation.” Appellant’s Br. 32-33. But, of course, a State’s direct subsidy of a local industry, like Indiana’s subsidization of New Energy, does not violate the Commerce Clause. See, e.g., *South-Central Timber Development, Inc. v. Wunnicke*, 467 U.S. 82, 95 (1984) (plurality opinion); *id.* at 103 (Rehnquist, J., dissenting). Thus, unlike Mississippi in *Great A&P Tea*, Ohio and South Point Ethanol have not eschewed meritorious litigation against an impermissible State regulation in favor of simple economic retaliation. And, as we show *infra* at 13-15, Ohio’s reciprocal tax credit is not discriminatory legislation within the meaning of the Court’s Commerce Clause jurisprudence.

In *Sporhase* the Court struck down a Nebraska statute that conditioned withdrawal of local groundwater for transportation across State lines on the destination State’s granting reciprocal rights of withdrawal and transportation into Nebraska. The Court acknowledged Nebraska’s “unquestionably legitimate and highly important” interest in conserving its groundwater, 458 U.S. at 954, and indicated that substantial licensing restrictions for interstate transportation would be permissible, *id.* at 955-57. Nebraska’s additional requirement of reciprocity, however, in conjunction with Colorado’s absolute prohibition on exportation of groundwater, “operate[d] as an explicit barrier to commerce between the two States.” *Id.* at 957. This explicit barrier to all interstate commerce in groundwater, and not simply the existence of a reciprocity provision *per se*, rendered the Nebraska law unconstitutional. *Id.* at 957-58.

Thus, neither *Great A&P Tea* nor *Sporhase* can properly be read as a sweeping constitutional prohibition of all reciprocal legislation. In each case the effect of the particular reciprocity provision, combined with the specific surrounding circumstances, was to effect a total barrier to interstate commerce. The only logical reasons for Louisiana’s particular reciprocity provision in *Great A&P Tea* were to bar Louisiana milk from being sold in Mississippi, or to compel Louisiana to lower its standards for milk imported from Louisiana.<sup>5</sup> Of course, neither

<sup>5</sup> Suppose that Louisiana’s Grade A milk standards were more stringent than Mississippi’s, so that Louisiana milk satisfied Mississippi’s health standards but Mississippi milk did not satisfy Louisiana’s. Since Louisiana milk was healthy by Mississippi standards, Mississippi could not properly prohibit the importation of Louisiana milk. Louisiana, however, could properly reject Mississippi milk, which did not meet Louisiana’s stricter health standards. The effect of Mississippi’s reciprocity requirement, therefore, would be either to compel Louisiana to lower its standards for milk

of these goals was permissible. Similarly, in *Sporhase* the reciprocity provision effectively precluded the exportation of any groundwater from Nebraska to Colorado. Because that total barrier to commerce could not be justified, the Nebraska statute fell under the standard of *Hughes v. Oklahoma*, 441 U.S. 322 (1979). See 458 U.S. at 957-58.

In sum, *Great A&P Tea* and *Sporhase* do not stand for the proposition that reciprocal legislation is unconstitutional *per se*, but only that reciprocal legislation will be struck down where the clear effect of that reciprocity is impermissible under the Commerce Clause.

B. Reciprocal legislation, however, does not necessarily have effects that are impermissible under the Commerce Clause. This conclusion, and the foregoing analysis of *Great A&P Tea* and *Sporhase* as not announcing a prohibition of all reciprocal legislation, are confirmed by the Court's decisions that address—and approve—reciprocity statutes. *Great A&P Tea* itself points to two such decisions, citing with approval *Bode v. Barrett*, 344 U.S. 583 (1953), and *Kane v. New Jersey*, 242 U.S. 160 (1916). See 424 U.S. at 378-79.

At issue in *Bode v. Barrett* was a tax that Illinois imposed for the use of its public highways based purely on a vehicle's gross weight. 344 U.S. at 584. The statute required Illinois residents and residents of other States to pay the same tax, but exempted nonresidents from the tax "provided the states of their residence reciprocate and grant like exemptions to Illinois residents." *Id.* at

imported from Mississippi, or to allow Louisiana's producers of admittedly healthy milk to be barred from the Mississippi market.

Alternatively, if Louisiana milk were inferior to Mississippi's, then the reciprocity requirement would allow lower quality milk into Mississippi. If this were the case, the reciprocity provision would disserve rather than promote Mississippi's asserted interest in public health, and therefore could not survive Commerce Clause scrutiny. See 424 U.S. at 375-76.

586 (emphasis added). The Court summarily rejected the interstate carriers' challenge to this reciprocity requirement, viewing the permissibility of "that kind of reciprocal arrangement" as settled law. *Ibid.*<sup>8</sup>

One of the decisions to which the *Bode* Court pointed was *Kane v. New Jersey*, *supra*. *Kane* upheld against challenge under the Commerce Clause and the Fourteenth Amendment a New Jersey law that required nonresidents to pay New Jersey an automobile registration fee if they drove in or through New Jersey. Mr. Kane, a New York resident, challenged the New Jersey statute on the ground that it did not contain a reciprocity clause, as did the Maryland law that the Court had upheld the previous year in *Hendrick v. Maryland*, 235 U.S. 610 (1915). There, "[t]he Maryland law contained a reciprocal provision by which nonresidents whose cars are duly registered in their home state are given, for a limited period, free use of the highways in return for similar privileges granted to residents of Maryland." 242 U.S. at 167-68; see 235 U.S. at 620. Such reciprocity provi-

<sup>8</sup> *Bode's* principal holding, that a State's simple gross vehicle weight tax is valid under the Commerce Clause, is open to question after the Court's decision last Term in *American Trucking Associations v. Scheiner*, 107 S. Ct. 2829 (1987). But *Scheiner* does not cast into doubt the reciprocity portion of the *Bode* decision. Indeed, *Scheiner's* reliance on the "internal consistency" test as the touchstone for determining the validity of a State tax strongly supports the permissibility of a reciprocity provision like that enacted by Illinois in *Bode*, or by Ohio here. In each case, the State tax, including the reciprocity requirement, is "of a kind that, 'if applied by every jurisdiction, there would be no impermissible interference with free trade.'" *Id.* at 2840 (quoting *Armo Inc. v. Hardesty*, 467 U.S. 638, 644 (1984)). If each State exempted nonresidents from a gross vehicle weight tax, then there would be no burden on interstate commerce from the States' imposition of such a tax. And, if each State granted a tax credit for ethanol produced in other States, subject to a reciprocity requirement like that in Ohio Rev. Code § 5735.145(B), then ethanol produced in each State would be eligible for a tax credit in all States.

sions, the *Kane* Court observed, had "become common in state legislation." 242 U.S. at 168.

Speaking through Justice Brandeis, the *Kane* Court ruled that this form of reciprocal legislation "is not an essential of valid regulation. Absence of it does not involve discrimination against nonresidents; for any resident similarly situated would be subjected to the same imposition." *Ibid.* Yet it was equally clear that such reciprocal legislation, if enacted, would also satisfy the Commerce Clause. That was the case in *Hendrick v. Maryland*, upon which *Kane v. New Jersey* relied. Indeed, the appellant in *Hendrick* was a resident of the District of Columbia, which did *not* have a reciprocal arrangement on automobile registration fees with Maryland. Nevertheless, the Court in *Hendrick* rejected the argument that Maryland's statute discriminated against residents of the District of Columbia, either as compared to Maryland residents or as compared to residents of other States that did have reciprocal arrangements with Maryland. 235 U.S. at 621.

Plainly, the highway taxes at issue in *Bode* and the automobile registration fees at issue in *Kane* and *Hendrick* presented questions under the Commerce Clause. In *Bode* the Illinois tax arguably burdened interstate carriers more than domestic carriers, and the effect of the reciprocity provision was to tax some interstate carriers but not others. In *Kane* and *Hendrick* the automobile registration fees similarly taxed out-of-state drivers, but only if their States chose to tax New Jersey or Maryland drivers. In each case these fees minimally "burdened" interstate commerce, through the additional costs imposed on interstate travel and the inconvenience imposed on nonresident motorists. But the taxes and fees did *not* "operate as an explicit barrier to commerce" between the States, *Sporhase*, 458 U.S. at 957, and they did *not* "threaten complete isolation as the alternative to acceptance of . . . reciprocity," *Great A&P Tea*, 424 U.S.

at 379. In each case, the State's reciprocal legislation was upheld. And, to our knowledge, these decisions upholding legislation granting exemptions from State fees and taxes to nonresidents who reside in reciprocating States have never been questioned.<sup>7</sup>

New Energy's sweeping assertion, that reciprocity laws are "facially discriminatory" and presumptively invalid under the Commerce Clause, is therefore incorrect. As Professor Michael Smith has described:

"If these reciprocity requirements are discriminatory on their face, they are an unusual instance of the type. They are not necessarily discriminatory in purpose . . .; a state may enact legislation requiring reciprocity with the genuine intention that other states will satisfy the requirement and thereby elimi-

<sup>7</sup> Reciprocity provisions such as these, in which a State conditions its grant of a tax exemption or credit on the availability of a similar tax credit or exemption in a sister State, are not uncommon. As the Court has noted, many States require reciprocity before crediting sales tax paid in another State against the home State's use tax. *Williams v. Vermont*, 105 S. Ct. 2465, 2471 (1985). (The Court has expressly reserved the question whether such a credit against a State's use tax is constitutionally required. *Ibid.*)

Moreover, the Court has upheld a variety of interstate agreements affected through reciprocal legislation in other contexts. See *U.S. Steel Corp. v. Multistate Tax Commission*, 434 U.S. 452, 469 (1978). For example, in upholding the Uniform Law to Secure the Attendance of Witnesses from Within or Without a State in Criminal Proceedings against a Privileges and Immunities Clause challenge, the Court explained:

"The Constitution did not purport to exhaust imagination and resourcefulness in devising fruitful interstate relationships. It is not to be construed to limit the variety of arrangements which are possible through voluntary and cooperative actions of individual States with a view to increasing harmony within the federalism created by the Constitution." *New York v. O'Neill*, 359 U.S. 1, 6 (1959).

The fact that this Act was adopted as a result of the States' self-interest, "serv[ing] a self-protective function for each of the enacting States," *id.* at 9, did not render the law invalid.

nate the difference in treatment between those outside and inside the state. Moreover, to the extent that this purpose is actually achieved, the requirements are not discriminatory in effect either.

"In any event, the Supreme Court clearly was right in [*Great A&P Tea*] when it observed that *not all reciprocity requirements are discriminatory*."

Smith, *State Discriminations Against Interstate Commerce*, 74 Cal. L. Rev. 1203, 1241 (1986) (emphasis added; footnotes omitted).

Accordingly, the Court should not declare Ohio Rev. Code § 5735.145(B) invalid merely because it is a form of reciprocal legislation. Rather, the Court must consider "the unique circumstances of the statute at issue and the particular circumstances" of this case. *Boston Stock Exchange v. State Tax Commission*, 429 U.S. at 329. As we now show, the Ohio ethanol tax credit validly promotes legitimate State interests and the national interest in commerce among the States.

## II. OHIO'S RECIPROCAL TAX CREDIT FOR ETHANOL IS NOT DISCRIMINATORY LEGISLATION. ON THE CONTRARY, THE STATUTE PROMOTES THE NATIONAL INTEREST IN INTERSTATE COMMERCE.

The trial court found that the Ohio General Assembly's purposes in enacting Ohio Rev. Code § 5735.145(B) included "promoting domestic industry," J. St. App. 63a, and promoting "a cleaner and safer environment for Ohio citizens by encouraging the use of ethanol as a replacement for lead in gasoline not only in Ohio but in all states," J.A. 44, J. St. App. 56a; *accord*, J. St. App. 6a. Appellant New Energy does not question that these State interests are in fact served by Ohio's ethanol tax credit, but instead contends that the former purpose is illegitimate, and that Ohio has sought to serve both purposes through a statute that discriminates against interstate

commerce or that excessively burdens that commerce. Neither contention is correct.

A. Although New Energy repeatedly refers to Ohio Rev. Code § 5735.145(B) as "facially discriminatory," it plainly is not discriminatory in either of the senses referred to by Professor Smith or accepted by this Court.

First, Ohio Rev. Code § 5735.145(B) lacks a discriminatory purpose. In contrast to the Mississippi milk statute in *Great A&P Tea*, the Ohio ethanol tax credit demonstrably is "legislation requiring reciprocity with the genuine intention that other states will satisfy the requirement." Smith, *supra*, at 1241. South Point Ethanol's general manager testified that South Point's support for the Ohio reciprocity clause in the Ohio General Assembly was based not on a desire to close the Ohio market to out-of-state firms, but "as an incentive to all states to enact legislation that would promote the sale of ethanol in their states." J.A. 139. And, the trial court found as fact that one of the Ohio General Assembly's principal purposes in enacting § 5735.145(B) was "to affect the policies of other states to grant reciprocal tax credits." J. St. App. 63a.<sup>8</sup> Thus, Ohio did not enact its reciprocal ethanol tax credit with the protectionist purpose of closing Ohio's ethanol market to out-of-state producers, but with the hope that Ohio's sister States would also enact, or would maintain, similar tax credits for ethanol.

Second, Ohio Rev. Code § 5735.145(B) has not had a discriminatory effect. A clear majority of States have enacted or have retained a tax credit for ethanol. Among the many States granting ethanol tax credits are Illinois

<sup>8</sup> As we show *infra* at 16-18, Ohio's legislative purpose of influencing the policies of other States, as applied in this case and effected through § 5735.145(B), is entirely legitimate. *E.g.*, *Metropolitan Life Insurance Co. v. Ward*, 470 U.S. 869, 877 n.6 (1985); *Western & Southern Life Insurance Co. v. State Board of Equalization*, 451 U.S. 648, 671 (1981); *U.S. Steel Corp. v. Multistate Tax Commission*, 434 U.S. 452, 478 (1978).

and Tennessee. Three major producers from those States—Archer Daniels Midland, Pekin Energy, and A.E. Staley—are eligible for the Ohio tax credit and vigorously compete with South Point Ethanol for ethanol sales in Ohio. The record contains no evidence that Ohio's reciprocal tax credit has had the effect of increasing the share of the Ohio ethanol market that is served by in-state, rather than out-of-state, producers.<sup>9</sup> Indeed, the parties agreed, and the trial court found, that "ADM, Pekin and Staley have the capacity to supply the portion of the Ohio market for ethanol presently being filled by [New Energy]." J.A. 28. Thus, there is no evidence to support a conclusion that Ohio's reciprocal legislation has had a discriminatory effect on interstate commerce.<sup>10</sup>

In sharp contrast to the statutes that the Court has struck down as violative of the Commerce Clause, Ohio's reciprocal ethanol tax credit does not have "the primary effect of prohibiting or discriminatorily burdening a resident's purchase of out-of-state goods or services." *Boston Stock Exchange v. State Tax Commission*, 429 U.S. at 336. Ohio has not used its taxing power "to assure that residents trade only in intrastate commerce," *id.* at 335, to divert out-of-state business operations to be per-

<sup>9</sup> Under the Commerce Clause, "[t]he burden to show discrimination rests on the party challenging the validity of the statute." *Hughes v. Oklahoma*, 441 U.S. 322, 336 (1979).

<sup>10</sup> *Amici* acknowledge that Ohio's reciprocity statute, in conjunction with Indiana's decision to enact a direct production subsidy (which benefits only New Energy) instead of a generally available tax credit, has disadvantaged New Energy in the Ohio market. New Energy, however, is not barred from competing in the Ohio market, or from benefitting in the Ohio marketplace from any cost advantages it gains from Indiana's direct subsidy. Moreover, it is well-established that the purpose of the Commerce Clause is to protect and promote interstate commerce, not to protect individual companies. "The fact that the burden of the state regulation falls on some interstate companies does not, by itself, establish a claim of discrimination against interstate commerce." *Exxon Corp. v. Maryland*, 437 U.S. 117, 126 (1978).

formed in Ohio, see *id.* at 336, or to gain an unfair advantage for Ohio-produced goods in interstate markets. Ohio Rev. Code § 5735.145(B) therefore is not discriminatory legislation within this Court's Commerce Clause jurisprudence.

B. Although New Energy contends that the Ohio ethanol tax credit burdens interstate commerce, the reality is that the Ohio statute *promotes* interstate commerce in ethanol. As such, the statute advances the national interest in commerce among the States, and can hardly be deemed to disturb the policies underlying the dormant Commerce Clause. The promotion of interstate commerce occurs in two independent fashions.

1. The record is clear and all parties agree that, but for the existence of tax credits, no market for the production and use of ethanol as a gasoline additive would exist. The federal government and various States have enacted credits, exemptions and subsidies to encourage ethanol production and its use as motor fuel. See Appellant's Br. 4-5; J.A. 25-26, 30-31. In fact, New Energy's chief executive officer testified that "[t]he only way we can currently do so [remain competitive with unblended gasoline] is through the state and federal incentives or credits that exist, and *absent those credits and ethanol would not be a viable factor in the market place today.*" J.A. 65 (emphasis added); see also J.A. 18. The parties agreed, and the trial court found, that "[t]he provision of tax credits has been the best method adopted by the federal and state governments to encourage the use of ethanol." J.A. 26.

Thus, far from acting as an *artificial barrier* to interstate commerce in ethanol, Ohio's tax credit is an *artificial incentive* to that commerce. Ohio has created a tax incentive, available to both in-state and out-of-state ethanol, to encourage ethanol's production and use. Without the Ohio credit, a much smaller market would exist

in Ohio for ethanol as a motor fuel, if indeed any market would exist at all.<sup>11</sup>

In these circumstances, it simply makes no sense to refer to Ohio Rev. Code § 5735.145 as a "burden" on interstate commerce. *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 807 (1976). Ohio's ethanol tax credit creates no barrier. Instead, the Ohio statute allows for the *expansion* of a market in interstate commerce that might not otherwise exist. That Ohio's reciprocity provision limits the incentive's availability to ethanol that is produced in other States that offer similar incentives does not alter that central fact. See *id.* at 815-17 (Stevens, J., concurring). Whether or not Indiana (or any other particular State) accepts Ohio's offer of reciprocity, there can be no dispute that Ohio's tax credit has created *more* commerce in ethanol, not less.

2. As the trial court found, one of the Ohio General Assembly's principal purposes in enacting its reciprocal

<sup>11</sup> Appellee South Point Ethanol argues that this simple, and undisputed, fact implies that Ohio's amendment of its ethanol tax credit statute to add a reciprocity requirement is not "the kind of action with which the Commerce Clause is concerned." *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 805 (1976). Relying on the Court's decision in *Alexandria Scrap*, South Point contends that where the affected commerce does not result from "the natural functioning of the interstate market," but rather is "created in whole or in substantial part," by the challenged State statute, *id.* at 809 n.18, the statute should not be read to give rise to "a burden which the Commerce Clause was intended to make suspect." *Id.* at 807; *accord, id.* at 816 (Stevens, J., concurring) ("[w]hether the encouragement takes the form of a cash subsidy, a tax credit, or a special privilege intended to attract investment capital, it should not be characterized as a 'burden' on commerce").

The *amici* States agree with South Point's arguments, although we do not restate them at length here. But even if South Point has overstated the case, and Ohio's use of a tax credit to enhance the ethanol market is not immune from review under the Commerce Clause, it is unassailably true that the Ohio tax credit promotes, rather than hinders, interstate commerce.

tax credit was "to affect the policies of other states to grant reciprocal tax credits." J. St. App. 63a. In this fashion, Ohio hoped to enhance the market in other States for ethanol, including ethanol that is produced in Ohio. New Energy acknowledges that this was one of the purposes of Ohio's reciprocal tax credit, but suggests that this State purpose is illegitimate. Appellant's Br. 31-33. Quite the contrary, Ohio's purpose in this regard was entirely legitimate and, in the particular circumstances presented here, furthers the national interest in commerce among the States.

The Court has squarely recognized "that promotion of local industry is a legitimate state interest in the Commerce Clause context." *Metropolitan Life Insurance Co. v. Ward*, 470 U.S. 869, 877 n.6 (1985); *accord, e.g., Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 271 (1984). Of course, a State may not seek to promote local industry through protectionist or discriminatory legislation. *E.g., Bacchus Imports*, 468 U.S. at 271; *Boston Stock Exchange*, 429 U.S. at 335-36. But, as we have described *supra* at 13-15, Ohio's reciprocal tax credit is *not* discriminatory legislation within the meaning of the Commerce Clause, either in purpose or effect.

In a pair of cases decided under the Equal Protection Clause—*Metropolitan Life Insurance Co. v. Ward*, *supra*, and *Western & Southern Life Insurance Co. v. Board of Equalization*, 451 U.S. 648 (1981)—the Court has drawn the line between permissible and impermissible promotion of domestic industry. Those cases held valid a State's efforts "to influence the policies of other States in order to enhance its domestic companies' ability to operate interstate," while striking down a State's erection of "barriers to foreign companies who wish to do interstate business in order to improve its domestic [companies'] ability to compete at home." *Metropolitan Life*, 470 U.S. at 877-78.

In short, "[t]here can be no doubt that promotion of domestic industry by deterring barriers to interstate business is a legitimate state purpose." *Western & Southern Life*, 451 U.S. at 671. Nor should there be any doubt that, if a State may lawfully enact reciprocal legislation to *deter* other States from creating *barriers* to interstate commerce (as California did in *Western & Southern Life*), then a State also may lawfully enact reciprocal legislation to *encourage* other States to create *incentives* to interstate commerce. That is precisely what Ohio has done here.

In this case, there was no need for Ohio to deter other States from creating barriers to interstate commerce in ethanol. The price structure of the unsubsidized marketplace was sufficient to preclude any meaningful commerce in ethanol as a gasoline additive without any further State action. Instead, Ohio's effort is to encourage other States to promote the production and use of ethanol through the enactment of tax credits, exemptions, or refunds.<sup>12</sup> Those States that agree with Ohio's policy, and enact or maintain tax incentives for ethanol used as a motor fuel, enhance interstate sales of ethanol, both from Ohio and non-Ohio producers. And, those States that choose not to enact ethanol tax incentives have no less commerce in ethanol than would have existed without Ohio's reciprocal legislation.

In sum, the reciprocity of Ohio Rev. Code § 5735.145(B) creates an incentive for other States to encourage interstate trade in ethanol. In stark contrast to the reciprocity provisions at issue in *Great A&P Tea* and *Sporhase*, Ohio's reciprocal ethanol tax credit thus promotes not only Ohio's legitimate State interests, but also the national interest in commerce among the States.

<sup>12</sup> The parties agreed, and the trial court found, that "[t]he provision of tax credits has been the best method adopted by the federal and state governments to encourage the use of ethanol." J.A. 26.

## CONCLUSION

For the foregoing reasons, the decision of the Supreme Court of Ohio should be affirmed.

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No. 87-654

Supreme Court, U.S.  
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IN THE  
**Supreme Court of the United States**

OCTOBER TERM, 1987

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**NEW ENERGY COMPANY OF INDIANA,**

*Appellant,*

v.

**JOANNE LIMBACH, TAX COMMISSIONER  
OF OHIO, and SOUTH POINT ETHANOL,**

*Appellees.*

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**On Appeal From The Supreme Court Of Ohio**

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**BRIEF OF THE STATE OF ILLINOIS  
AS AMICUS CURIAE  
IN SUPPORT OF APPELLEES**

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BRIEF OF THE STATE OF ILLINOIS  
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---

INTEREST OF THE STATE OF ILLINOIS

---

[T]he ethanol market has continued to grow, *stimulated especially by farmers' economic problems.* (emphasis supplied)

Brief of Appellant, New Energy Co., at p. 7.

The raw materials from which the overwhelming majority of domestic ethanol is distilled are corn and cereal grain. Illinois is a major producer of these agricultural

raw materials, and is also a major producer of ethanol. The current "farm crisis," a result of the increase in the price of materials, equipment, debt service and fuels, as well as the concurrent decrease in the price that agricultural products can muster due to large surpluses, has adversely affected the farmers of Illinois and the nation. There are two ways to solve the crisis. The first method, governmental disincentives to production, is costly and, though necessary, inherently abhorrent. The second method is to increase demand. Illinois prefers the latter method and has adopted legislation similar to that reviewed in this appeal.<sup>1</sup> Increased demand for ethanol results in increased demand for farm products, since a bushel of corn yields approximately 2.5 gallons of ethanol. The demand for ethanol will not increase unless states like Illinois and Ohio subsidize ethanol producers and fuel blend retailers.

The Ohio legislation, by encouraging the increased use of ethanol fuel blends, benefits all farmers, including those from Indiana and Illinois. Illinois therefore has a great interest in advancing the cause of measures which expand the market for farm products, generate farm income and reduce the amount of price-support payments made necessary by the farm crisis. Although the Ohio legislation was in part adopted to assure a healthful environment for the

<sup>1</sup> See, Ill. Rev. Stat. ch. 120, § 442 (1985). In 1985 an independent fuel blend retailer challenged the Illinois statute on Commerce Clause grounds. The trial court upheld that challenge and a direct appeal of that ruling is presently before the Illinois Supreme Court pursuant to its Rule 302(a). *Russell Stewart Oil Co. v. Department of Revenue*, Ill. S.Ct. No. 63630. The case was argued in November and the parties have since advised the Illinois Supreme Court of the instant appeal. Contrary to the appellant's claim in its jurisdictional statement, p. 13, there is no official opinion of the Illinois Attorney General regarding the Illinois statute; the letter to which appellants refer clearly states that it is not an official opinion, and that letter pre-dates the enactment of the Illinois law.

citizens of Ohio, and it undoubtedly furthers that interest, the State of Illinois submits that additional vital state interests are furthered by Ohio R.C. 5735.145(B) and similar legislation, such as that of Illinois.

## SUMMARY OF THE ARGUMENT

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In a natural economic environment, where the fate of commerce in a particular commodity is determined by the forces of supply and demand, the fuel ethanol industry would not exist. The industry is the result of massive state and federal investment in the form of loans, loan guarantees, excise tax exemptions, sale and use tax exemptions, credits and other forms of allowances and incentives. Since the federal excise tax exemption for fuel blends is insufficient to render such blends competitive with gasoline, Congress envisioned that state subsidies would be necessary to render the blends competitive. Ohio and Illinois are among the states that subsidize their own ethanol industry and, although they are under no obligation to do so under the Commerce Clause, they also subsidize the industry of other states. In essence, the claim of New Energy Company of Indiana is that Ohio has an obligation to spend money on New Energy Company. The Constitution imposes no such obligation on any state. *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794 (1976).

The industry that provides the raw materials for ethanol production, the corn and cereal grain industry, is also supported by massive state and federal involvement. In addition to the beneficial environmental consequences from the increased use of ethanol fuel blends, another motivation for the creation and maintenance of the ethanol in-

dustry is that increased demand for ethanol will reduce the surplus of grain, increase the market price of grain and reduce the amount of governmental price supports that the grain industry receives. All states, including Indiana, benefit from the increased demand for fuel blends which R.C. 5735.145(B) generates. Even if the reduced participation of New Energy Company in the Ohio gasoline market is viewed as a burden, that burden is far outweighed by the benefits to the corn and grain industry of all states.

If the analysis of *Pike v. Bruce Church*, 397 U.S. 137 (1970), is applicable to legislation which subsidizes a government created commerce, then a major flaw in the analysis must be corrected. The scope of the Court's inquiry into the affected commerce must not be limited to that commerce in which the plaintiff or its industry participates. The inquiry must expand into other markets and industries which may be affected by the legislation and which may enjoy a substantial benefit even if the plaintiff does not enjoy a similar benefit. That expansion is particularly appropriate where the plaintiff's industry is merely a conduit for other governmental objectives in other markets and industries. An inquiry which does not take into account the benefits of the legislation if they occur in an industry other than that of the plaintiff is an unwarranted infringement of the sovereign power of the states to act where Congress has not acted. The Ohio legislation does not burden commerce. It increases the flow of commerce in the ethanol industry and, more importantly, in the industry which the ethanol industry was created to advance, the corn and cereal grain industry. The decision of the Ohio Supreme Court upholding R.C. 5735.145(B) should be affirmed.

## ARGUMENT

### I.

#### **THERE IS NO NATURAL FUNCTIONING INTERSTATE MARKET IN FUEL ETHANOL.**

If natural economic forces of supply and demand had free play, the fuel ethanol industry and market would not exist. Consumers do not want ethanol fuel blends; the federal and state governments want them. Governments advocate the production and use of ethanol fuel blends as a means to remedy or alleviate local and national environmental and economic ailments. Amelioration of such ailments is not set in motion until the price of the ethanol fuel blend is sufficiently reduced, by governmental rather than economic forces, so that the blend is competitive with gasoline.

The cost to the state and federal governments to start up the process and maintain it in operation is substantial. For 1985, the total cost to those states that confer subsidies for ethanol production was \$302.5 million.<sup>2</sup> The cost to the federal government of the gasoline excise tax exemption for ethanol fuel blends was \$1,518,000,000 in 1987 and is projected at \$3,291,000,000 by 1991.<sup>3</sup> Even with that massive federal expenditure, unless the states also invest subsidy funds, the blends will still be priced substantially higher than gasoline and the consumer will reject them, thus thwarting both the state and federal objectives. So, clearly, the federal government depends upon some sort of state expenditure, such as Ohio has

<sup>2</sup> See Fuel Ethanol and Agriculture, An Economic Assessment, p. 10 (USDA Agricultural Economic Report No. 562, August, 1986), hereinafter referred to as the "Agricultural Economic Report."

<sup>3</sup> *Id.* at p. 11.

made and Indiana has not, to increase the amount of ethanol produced and broaden its share of the gasoline market.<sup>4</sup>

The ethanol industry and market were created and are maintained by government expenditures as a means to achieve other governmental objectives such as improving the quality of the air we breathe, reducing the amount of deficiency payments and other price support programs, and reducing the amount of imported oil. The extent to which the ethanol industry owes its existence to the programs of the state and federal governments and the cost of creating and maintaining that industry are easily apparent from a review of the federal legislation dealing with ethanol as a means to reduce dependence on foreign oil and to reduce the grain surplus.<sup>5</sup> Time and space lim-

<sup>4</sup> See The Agricultural Economic Report, at page 37, which concluded that "The fuel ethanol industry is not likely to survive the next decade without large Federal and State subsidies. The price of gasoline is not expected to again reach the high level achieved in 1980 until well after 1995. Therefore, a subsidy in excess of the \$0.60 per gallon of ethanol provided by the Federal excise tax exemption will be necessary for most existing ethanol plants to continue operating. Without additional subsidies, growth in the ethanol industry is unlikely." See also, New Energy Co. brief at p. 6.

<sup>5</sup> The Solar Energy, Research, Development, and Demonstration Act of 1974 (P.L. 93-473) authorized research into and development of means for "the conversion of cellulose and other organic materials . . . to useful energy or fuels"; The Food and Agriculture Act of 1977 authorized loan guarantees of up to \$15 million each for four biomass (ethanol from vegetative material) pilot plants, administered by the FHA and the Commodity Credit Corporation; The Energy Tax Act of 1978 (P.L. 95-618) exempted certain fuel blends from the \$0.04 per gallon Federal Excise Tax on gasoline through 1984 and provided a 10% energy investment tax credit (EITC) for equipment used to convert biomass to alcohol; The Interior and Related Agencies Act of 1979 (P.L. 96-126) appropriated \$19 billion for an "Energy Security Reserve" to stimulate com-

(Footnote continued on following page)

<sup>5</sup> continued

mercial production of alternative fuels, and earmarked \$100 million each for product development studies and for cooperative agreements to support commercial scale developments; The Crude Oil Windfall Profit Tax Act of 1980 (P.L. 96-223) extended the \$0.04 per gallon Federal excise tax exemption to 1992, extended the eligibility for EITC's to 1985, and provided an income tax credit to blenders of \$.40 per gallon of ethanol; The Energy Security Act of 1980 (P.L. 96-294) provided insurance for loans of \$1 million or less to small scale biomass producers, provided loan guarantees to cover 90% of the construction cost of biomass energy projects; provided price guarantees for products of biomass energy projects, and authorized the United States Department of Agriculture and the Department of Energy to spend \$600 million on biomass energy projects; The Consolidated Farm and Rural Development Act of 1980 (P.L. 96-438) authorized the Farmers Home Administration to guarantee loans for alcohol production; The Agricultural Act of 1980 (P.L. 96-494) established an Alcohol Processor Grain Reserve Program which, upon a determination by the Secretary of Agriculture that alcohol producers cannot obtain grain at reasonable prices, will lend grain to federally financed producers (due to the grain surplus this provision has not been activated); The Omnibus Reconciliation Act of 1980 (P.L. 96-499) imposed an additional duty on imports of ethyl alcohol to be used as fuel of 10 cents per gallon in 1981, 20 cents in 1982 and 40 cents from 1983 through 1992; The Agriculture and Food Act of 1981 (P.L. 97-98) authorized the sale of government-owned corn below the statutory sale prices whenever supplies are not readily available (due to the grain surplus this provision has not been activated); The Emergency Preparedness Act of 1982 (P.L. 97-229) authorized the establishment of a Strategic Alcohol Fuel Reserve to stockpile alcohol fuel made from government-owned corn; The Surplus Agricultural Commodities Disposal Act of 1982 (P.L. 97-358) amended the Agricultural Act of 1949 to authorize the Secretary of Agriculture to use surplus stocks of grain for conversion to fuel alcohol; The Surface Transportation Assistance Act of 1982 (P.L. 97-424) raised the federal excise tax on gasoline to \$.09 per gallon but increased the exemption for blend fuels from \$.05 to \$.09 per gallon, and also increased the income tax credit to the fuel blender from \$.40 to \$.50 per gallon; The Tax Reform Act of 1984 (P.L. 98-369) increased the fuel blender's income tax credit to \$.60 per gallon and provides a \$.06 per gallon of blended fuel exemption from the federal excise tax on gasoline; The Food Security Act of 1985 (P.L. 99-198) authorized the Secretary of Agriculture to make government-owned commodities available for free or at a reduced cost for production of liquid fuels; The Surface Transportation Act of 1987 (P.L. 100-

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itations prohibit a similar review of state programs and an assessment of their great expense.

In industries and markets created or maintained solely by virtue of state subsidies, the analysis used in prior "reciprocity" cases does not work. In those cases the statutes were "designed to neutralize the advantages belonging to the place of origin." *Baldwin v. Seelig*, 294 U.S. 511, 527 (1934). The only advantage one ethanol blend enjoys over another is the credit, exemption or grant that a state may confer. Since Indiana has chosen not to subsidize ethanol, ethanol from New Energy Co. of Indiana brings to Ohio no advantage that can be neutralized. The common thread of *Baldwin v. Seelig*, 294 U.S. 511 (1934), *Great Atlantic & Pacific Tea Co. v. Cottrell*, 424 U.S. 366 (1976), and *Sporhase v. Nebraska ex rel. Douglas*, 458 U.S. 941 (1982), is that "the state interfered with the *natural functioning* of the interstate market either through prohibition or through burdensome regulation." *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 806 (1976) (emphasis supplied). There is no natural functioning interstate market in fuel ethanol, and therefore those cases are inapposite.

<sup>5</sup> continued

117) extended the excise tax exemption for blended fuel to 1993; The Farm Disaster Assistance Act of 1987 (P.L. 100-45) required the Secretary of Agriculture to select a seven-member panel to conduct a study of the cost-effectiveness of ethanol production. (The report of that Panel is referred to herein as the National Advisory Panel Report).

## II.

### SUBSIDIES ALSO SUSTAIN THE CORN INDUSTRY THAT PROVIDES THE RAW MATERIAL FOR ETHANOL PRODUCTION, AND GREATER FUEL BLEND PENETRATION IN THE GASOLINE MARKET MAY WEAN THE FARM SECTOR FROM SUBSIDIES.

Corn is currently, and will probably remain, the predominant ethanol feedstock, with important contributions from several other grains and feedstocks.<sup>6</sup> Corn is the feedstock for 85 percent of domestic ethanol production, and other cereal grains supply an additional 3 percent of domestic production.<sup>7</sup> In 1979, total domestic ethanol production was only 20 million gallons, but it grew to 555 million gallons by 1985.<sup>8</sup> From 1979 to 1985 the utilization of grain for domestic ethanol production grew from 8 million bushels to 195 million bushels.<sup>9</sup> The current level of domestic production is at 850 million gallons per year and is moderately estimated to reach 1.1 billion gallons per year in 1992.<sup>10</sup>

Ethanol production will provide benefits to the agricultural sector in terms of higher prices for corn and other feed grains, increased farm income, and savings in agricultural program costs for ethanol.<sup>11</sup> On the average, net

<sup>6</sup> See Fuel Ethanol Cost-Effectiveness Study, xvi (National Advisory Panel on Cost-Effectiveness of Fuel Ethanol Production—Final Report to Congress and the Secretary of Agriculture, Nov. 1987), hereinafter referred to as the "National Advisory Panel Report".

<sup>7</sup> Appendix, Exhibit A, Feedstock Utilization as a Percentage of Current Ethanol Production.

<sup>8</sup> Appendix, Exhibit B, U.S. Ethanol Production Utilization of Grain, 1979-1985.

<sup>9</sup> Appendix, Exhibit C, U.S. Ethanol Production 1979-1985.

<sup>10</sup> National Advisory Panel Report at p. xviii.

<sup>11</sup> *Id.* at p. xiii.

farm income increases by \$0.58 for each additional gallon of ethanol produced, or a projected \$2.2 billion between 1986-1994.<sup>12</sup> More importantly, governmental savings in reduced deficiency payments to corn growers will amount to \$3.3 billion between 1986-1994, because increased use of corn for ethanol production will lead to higher corn prices and smaller inventories of reserves.<sup>13</sup>

It is undoubted that the subsidy granted by R.C. 5735.145(B) encourages other states to increase the export of ethanol to Ohio and thereby makes ethanol available to Ohio consumers at prices that compete with gasoline. Likewise, the subsidies of other states encourage the export of ethanol from Ohio to those states and make ethanol available to consumers in those states at prices that can compete with gasoline. While Ohio may not be subsidizing Indiana's fuel ethanol industry in the same manner that it subsidizes that of other states, it is subsidizing Indiana's corn growers and those of *every* state regardless of the state's policy towards fuel ethanol. Indiana corn growers benefit on a par with corn growers in every state from the increased demand for ethanol blends and its consequent effect on the supply and price of corn. Each 100 million bushel increase in the demand for corn for ethanol production increases corn prices by \$0.02 to \$0.04 per bushel.<sup>14</sup> Any increase in the price of corn will lead to a decrease in the amount of deficiency payments from the government to farmers.<sup>15</sup>

<sup>12</sup> Agricultural Economic Report at p. 38.

<sup>13</sup> Agricultural Economic Report at p. 32.

<sup>14</sup> Agricultural Economic Report at p. 31.

<sup>15</sup> The Agricultural Economic Report concluded that ethanol production is a very costly proposition for the United States and that its major benefit, higher net farm income, was gained at the cost

(Footnote continued on following page)

### III.

**THE PRINCIPLE OF *HUGHES V. ALEXANDRIA SCRAP CORP.*, 426 U.S. 794 (1976), GAINS ADDED RELEVANCE WHERE THE STATE MUST LOWER THE PRICE OF THE FINISHED GOOD TO MAKE IT COMPETITIVE, IN ORDER TO BID UP THE PRICE OF THE RAW MATERIAL AND THUS REDUCE STATE AND FEDERAL PRICE SUPPORTS.**

In *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794 (1976), the Court rejected a Commerce Clause challenge to a Maryland provision offering a bounty on inoperable automobile hulks. The law placed in-state scrap processors at an advantage over all out-of-state scrap processors. The Court noted that "[w]e would hesitate to hold that the Commerce Clause forbids state action reducing or eliminating a flow of a commerce dependent for its existence upon state subsidy instead of private market forces." *Id.* at 809, n. 18. Here, the only alleged reduction of commerce is in the flow of ethanol from New Energy Co. However, an increase in the flow of fuel ethanol is

#### <sup>15</sup> continued

of higher consumer expenditures. *Id.* at p. 38. The National Advisory Panel Report concluded that "[i]n considering future ethanol policy, Congress and the Federal Government should weigh *all* the costs and benefits of ethanol production." p. xix (emphasis supplied). See, *The Tradeoff Between Federal Ethanol Subsidies and Agricultural Program Costs: An Economic Study*, Prof. John Umbek, Purdue University. A report prepared for the National Corn Growers Association after the USDA Agricultural Economic Report, and using some of the same assumptions as that report, concluded that the USDA report set forth only minimum savings based on some unrealistic assumptions, such as that the government would recover 100% of its farm loan costs (p. 20), that government's corn storage costs were \$2.65 per bushel when in reality they are \$3.15 per bushel (p. 19), and that there would be no spoilage or deterioration of stored grain over time, and it ignored the effect of increased demand for corn on the government's deficiency payments.

achieved by the participation of other out-of-state producers who can compete with gasoline in Ohio, and Ohio producers who can also penetrate markets in other subsidizing states. Moreover, the flow of surplus grain is increased from *all* states, including Indiana.

It is clear that New Energy Co. could not argue that the failure of the Indiana legislature to spend any funds is a violation of the Commerce Clause, even though Indiana's failure to subsidize its own ethanol industry may disable New Energy from competing with gasoline sold in its own home state, as well as competing with gasoline in sister states. New Energy also could not argue that Ohio would violate the Commerce Clause if it decided to remove the subsidy entirely for both Ohio and out-of-state producers, for then ethanol, regardless of its source-state, would be unable to compete with gasoline entirely. The concurring opinion in *Hughes v. Alexandria Scrap Corp.*, *supra*, noted that "[u]nquestionably Maryland could terminate its entire program, discontinuing subsidy payments to Maryland operators as well as out-of-state firms, without offending the Constitution." 426 U.S. at 816. Thus, New Energy cannot argue that Ohio violates the Commerce Clause because it does not subsidize all out-of-state producers as well as its own producers; "[a] failure to create that commerce would have been unobjectionable because the Commerce Clause surely does not impose upon the States any obligation to subsidize out-of-state businesses." *Id.*

As in *Alexandria Scrap*, the novelty here is that New Energy should characterize a subsidy to out-of-state business, which a state is under no obligation to provide, "as a burden which the Commerce Clause was intended to make suspect." *Id.* at 807. Just as "[n]othing in the purpose animating the Commerce Clause forbids a state, in the absence of congressional action, from participating in the market and exercising the right to favor its own citi-

zens over others" (*id.* at 810), here the concern over protective favoritism is not warranted because the Ohio statute subsidizes producers from other states as well as those of Ohio, *even if the out-of-state product has a lower pre-subsidy price than the Ohio product*. A major out-of-state producer may, by economies of scale, be able to produce ethanol at a sufficiently lower price than an Ohio producer and, with the Ohio subsidy, be able to compete more effectively against gasoline in Ohio.<sup>16</sup>

More importantly, Ohio may not be subsidizing Indiana's ethanol industry but it is increasing the demand for grain, including grain from Indiana. Ohio is raising the national market price of grain, which may result in better prices for Indiana corn products and in reduced deficiency payments to Indiana's farmers, as well as to those in every corn-growing state. Given the extent of state participation in both the ethanol industry and in the agricultural sector, the reason for application of the principles first established in *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794 (1976), is more compelling here than in that case.

#### IV.

**IF THE COURT DECIDES THAT *PIKE V. BRUCE CHURCH*, 397 U.S. 137 (1970), IS APPLICABLE TO A STATUTE THAT SUBSIDIZES A GOVERNMENT CREATED COMMERCE, THEN THE TEST MUST BROADEN THE SCOPE OF INQUIRY INTO THE EFFECT ON COMMERCE.**

Under *Pike v. Bruce Church*, 397 U.S. 137 (1970), a statute evidencing a non-protectionist purpose and effect, and promoting a legitimate state interest, will be upheld unless

<sup>16</sup> See Appendix, Exhibit D, Ethanol Anhydrous Capacity of Major Plants. For example, the ADM facility in Decatur, Illinois, can produce almost as much ethanol as New Energy Co. and South Point Ethanol.

it imposes a clearly excessive burden on commerce relative to the nature of the interest advanced. *Id.* at 192. The first part of the *Pike* test, requiring that the statute be facially neutral, eliminates those statutes which expressly or inherently protect the in-state industry from out-of-state competitors. A statute which subsidizes industry, particularly out-of-state industry, should not be subject to that analysis. Justice Powell, author of *Alexandria Scrap Corp.*, *supra*, noted in the dissent in *Reeves v. Stake*, 447 U.S. 429 (1980), that:

By "protectionism," I refer to state policies designed to protect private economic interests within the State from the forces of the interstate market. *I would exclude from this term* policies relating to traditional governmental functions, such as education, *and subsidy programs* like the one at issue in *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 49 L.Ed.2d 220, 96 S.Ct. 2488 (1976). (emphasis supplied)

*Id.* at p. 447, n. 1.

While most ethanol market participants are private companies (heavily backed by government loans and guarantees), their participation is possible only through government expenditure either by tax credits, refunds or exemptions. A distinction between a private and a governmental function "is whether the activity is supported with general tax funds, as was the case for the reprocessing program in *Alexandria Scrap* or whether it is financed by the revenue it generates." *Id.* at p. 453, n.3. Thus, statutes such as Ohio R.C. 5735.145(B), and Ill.Rev.Stat. ch. 120, ¶442 (1985), are not the type of statute to which the *Pike* test, or at least its first requirement, applies. *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794 (1976); *Reeves v. Stake*, 447 U.S. 429, 447, 452 (1980).<sup>17</sup>

<sup>17</sup> Here, R.C. 5735.145(B) expressly confers on an out-of-state competitor the same subsidy that is conferred on the sole Ohio pro-

(Footnote continued on following page)

Should the Court decide, however, that the remainder of the *Pike* test is applicable, that is, that the subsidy is really "a burden which the Commerce Clause was intended to make suspect," *Hughes v. Alexandria Scrap Corp.*, 426 U.S. at 807, and that the burden must be weighed "in relation to the putative local benefit," to determine if it is a clearly excessive burden, *Pike v. Bruce Church*, 397 U.S. at 142, then the Court should not limit the inquiry to the effect on the commerce in ethanol only. An inquiry as to the effect of a statute upon commerce must commence by defining the relevant commerce. The definition, and therefore the scope of analysis, should not be controlled by the industry to which the plaintiff belongs, nor by the industry which the statute expressly addresses. Rather, the definition should take into account the many state purposes which the statute may advance, although it does not express them, and the many industries which touch upon the plaintiff's business or industry, although they are not the subject of the statute. Such a broadened inquiry is particularly appropriate where, as here, the plaintiff's industry was created by government as a conduit for promoting broad societal interests related to decreasing dependence on foreign oil, reducing corn surpluses and reducing harmful pollutants, rather than merely to promote the ethanol industry for its own sake.

It is proper to examine industries other than the one immediately subject to the legislation. In *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456 (1981), the statute at issue there banned the retail sale of milk in non-

<sup>17</sup> *continued*

ducer. On its face, therefore, it does not demonstrate a protectionist purpose nor indicate that it will have a protectionist effect in its application. In application, it is plain that ethanol from any state that subsidizes ethanol will receive a subsidy in Ohio *even if the pre-subsidy price is lower than that of ethanol produced in Ohio*. In its effect, therefore, R.C. 5735.145(B) is not protectionist.

returnable, non-refillable containers made of plastic. The Court noted that:

Within Minnesota, business will presumably shift from manufacturers of plastic nonreturnable containers to producers of paperboard cartons, refillable bottles and plastic pouches, but there is no reason to suspect that the gainers will be Minnesota firms, or that the losers will be out-of-state firms. . . . Pulpwood producers are the only Minnesota industry likely to benefit significantly from the Act at the expense of out-of-state firms.

*Id.* at 472-73.

Here, there is every reason to believe that the larger non-Ohio ethanol producers will increase their participation in Ohio.<sup>18</sup>

More importantly, in *Minnesota v. Clover Leaf Creamery*, although the case involved the milk container industry, the Court looked to the industry supplying raw materials for the container industry and concluded that the local pulpwood industry would benefit at the expense of out-of-state raw materials suppliers, although permissibly so. Here, it is proper to look to the raw material source for the ethanol industry—corn and cereal grains—and, unlike *Minnesota v. Clover Leaf Creamery*, the benefit to that industry is not limited to any state nor is a corn

<sup>18</sup> There is also no reason to believe New Energy is driven out of the Ohio market. There are many non-fuel commercial uses for ethanol, and there are many ways in which a fuel ethanol producer or dealer can reduce purchasing and transportation costs. Nothing in the Commerce Clause insulates New Energy Co. from the economic necessity of initiative and resourcefulness, or guarantees to it the current operating structure that it has. This Court has said that it cannot “accept [the] underlying notion that the Commerce Clause protects the particular structure or methods of operation in a retail market.” *Exxon v. Governor of Maryland*, 437 U.S. 117, 127 (1987).

grower in one state favored over one in another state. As New Energy Co. notes, South Point Ethanol of Ohio purchases corn from Ohio *and* Indiana. Corn growers in Indiana directly benefit from the increased demand for their product from South Point Ethanol and the non-Ohio companies that increase their penetration into the Ohio gasoline market. Corn growers in *every* state benefit from the rise in prices which accompanies the increased demand. For example, the average increase in farm income for each additional gallon of ethanol produced and marketed due to R.C. 5735.145(B) will be \$.58 per gallon over the 1986-94 period;<sup>19</sup> and the average savings to the federal government will be \$.88 per gallon over the same period.<sup>20</sup> If the analysis of *Pike v. Bruce Church*, 397 U.S. 137 (1970), is at all applicable to state created and maintained commerce which does not respond to natural economic forces, then it must take into account the benefits conferred by R.C. 5735.145(B) on all of commerce, for to do otherwise unduly deprives sovereign states of the right to enact economic legislation where Congress has not preempted the field.

Having defined the relevant commerce, *Pike* requires that the “burden” be weighed against the putative local benefit to determine if the burden is so excessive that it competes with the national interest furthered by the Commerce Clause. The national interest furthered by the negative or dormant commerce clause, that of preventing state lines from becoming “barriers to the free flow of both raw materials and finished goods in response to the economic laws of supply and demand,” *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 806 (1976), is furthered rather than infringed by R.C. 5735.145(B) or similar laws.

<sup>19</sup> Agricultural Economic Report at p. 38.

<sup>20</sup> *Id.* at p. 34.

Fuel ethanol and surplus corn, by the economic laws of supply and demand, do not flow freely in commerce. Such trade exists and remains viable only through massive state and federal expenditures. Illinois and Ohio, among other states, have recognized that the state and national interests coincide and require the expenditure of funds to develop alternative markets for farm products in order to resolve the farm crisis.<sup>21</sup>

It is important "to differentiate between commerce which flourishes in a free market and commerce which owes its existence to a state subsidy program." *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 815 (1976). Such a distinction and concern shaped the decision in *Parker v. Brown*, 317 U.S. 341 (1943). In *Parker*, the Court upheld the raisin marketing program provisions of the California Agricultural Prorate Act against anti-trust and Commerce Clause challenges brought by a producer and packer of raisins. The program compelled delivery of over two-thirds of the raisin crop to a program committee, which controlled the marketing of the crop in order to enhance or maintain the price by means of restraints on competition between producers. The Court accepted at the outset that the program had a substantial effect on interstate commerce. The question then was whether, in the absence of congressional action prohibiting or regulating such transactions, the program violated the Commerce Clause.

<sup>21</sup> The National Advisory Panel concluded that "[o]ne perspective that must not be lost as the impact of ethanol on the agricultural sector is considered, is the long-term implications versus the near-term impacts. In an era of worldwide overproduction of grains, this excess production capacity is considered a burden to the trade and economic policies of many countries. Nontraditional industrial uses for grains should be viewed in the context of a tool to increase long-term demand. An increase in the long-term demand is the only permanent solution to the continuing high cost of supporting the farm sector." National Advisory Panel Report at p. xix.

The Court noted that when Congress has not exercised its powers under the Commerce Clause, and a state exercises its sovereign powers by legislation that has an effect on commerce, "the reconciliation of the power thus granted with that reserved to the state is to be attained by the accommodation of the competing demands of the state and national interests involved." *Id.* at 362. The Court then concluded that the effect of the program on national commerce was "such as to not conflict but coincide with a policy which congress has established with respect to it." *Id.* at 363. The same conclusion is warranted here and the factors considered by the *Parker* Court in validating the California program, being present here, merit validation of Ohio's legislation.

The Court discussed the severely depressed state of the raisin industry, and detailed the extensive and expensive state and federal loan, subsidy and assistance programs designed to reduce the surplus of raisins and raise the market price of raisins. The opinion could just as easily have been describing the current farm crisis and the state and federal programs it made necessary. The Court stated that:

The history shows clearly enough that the adoption of legislative measures to prevent the demoralization of the industry by stabilizing the market of the raisin crop is a matter of state as well as national concern and, in the absence of inconsistent Congressional action, is a problem whose solution is peculiarly within the province of the state. . . . In comparing the relative weights of the conflicting local and national interests involved, it is significant that Congress, by its agricultural legislation, has recognized the distressed condition of much of the agricultural production of the United States, and has authorized marketing procedures, substantially like the California prorate program, for stabilizing the marketing of agricultural products. . . . Hence we cannot say that the effect

of the state program on interstate commerce is one which conflicts with Congressional policy or is such as to preclude the state from this exercise of its reserved power to regulate domestic agricultural production.

317 U.S. at 367-368.

The same findings can be made here, not only as to the corn industry but also about the ethanol industry. Ohio R.C. 5735.145(B) serves the interests of the federal government and the majority of state governments by promoting the common cause of making the air safer to breathe, reducing reliance on foreign oil, and decreasing the surplus of corn, thus raising the price of grain and reducing the subsidies that governments must pay. Not only is a subsidy not a "burden" such as the Commerce Clause was intended to prohibit, but its effect on interstate commerce does not infringe upon or compete with any national interest.

Absent state subsidies, such as those which Ohio, Illinois and other states have been willing to make, there would be no flow of ethanol in interstate commerce. Ohio R.C. 5735.145(B) increases the flow of ethanol and efficiently achieves the penetration of blended fuels into the gasoline market to improve the quality of the environment and increase the demand for surplus grain. It may be that at some time Congress will decide that a more uniform system of furthering these goals is necessary but, until such a decision is made, state legislation should not be invalidated on the ground that the state must subsidize the ethanol industry of all states rather than subsidize the industry of those states which provide the greatest opportunity for market penetration prior to the expiration of the federal excise tax exemption for fuel blends in 1992. Such legislation should not be invalidated when in fact it does subsidize the grain industry of all states, including Indiana.

## CONCLUSION

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The State of Illinois respectfully submits that the decision of the Ohio Supreme Court should be affirmed.

Respectfully submitted,

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## **APPENDIX**

FEEDSTOCK UTILIZATION AS A PERCENTAGE OF  
CURRENT ETHANOL PRODUCTION

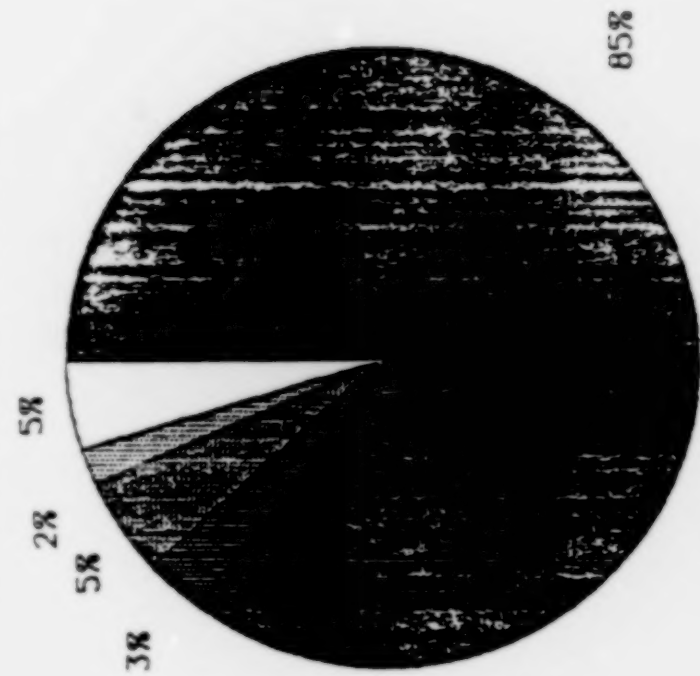
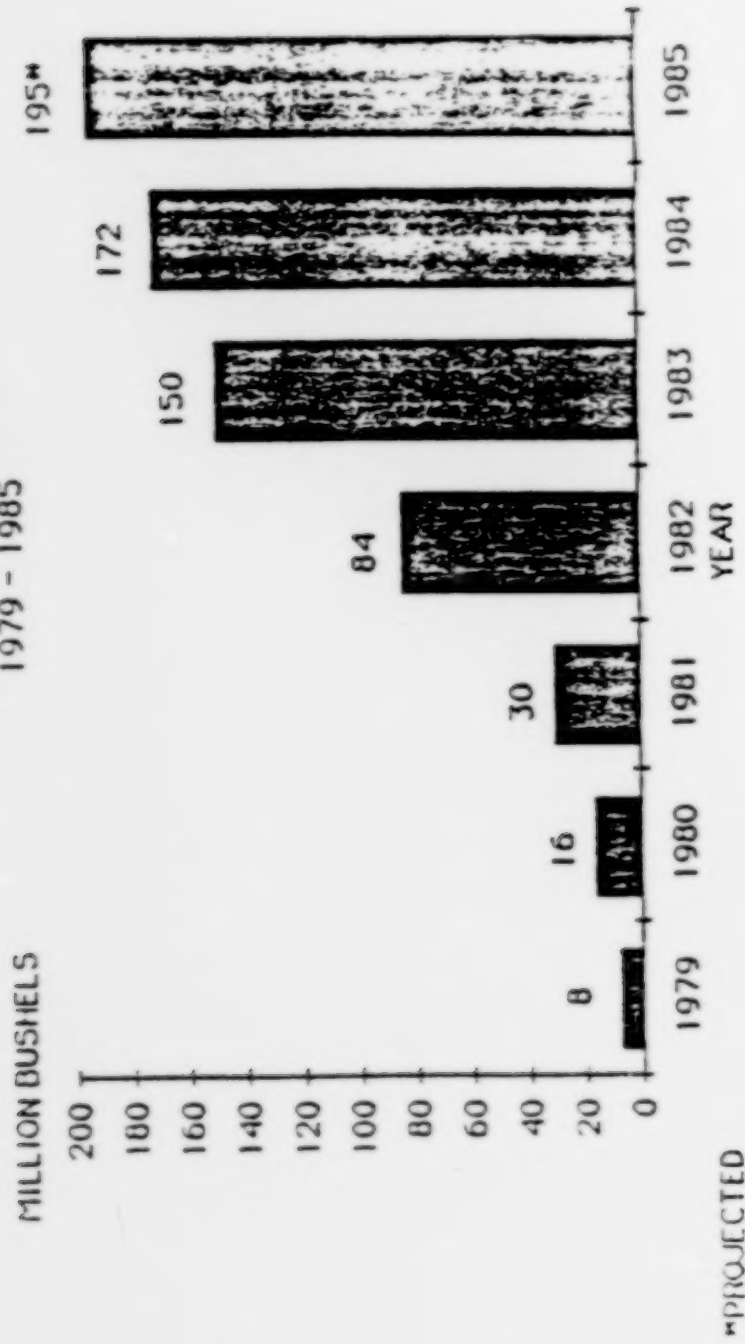


Exhibit A

SOURCE: INFORMATION RESOURCES  
INCORPORATED

# U.S. FUEL ETHANOL PRODUCTION UTILIZATION OF GRAIN

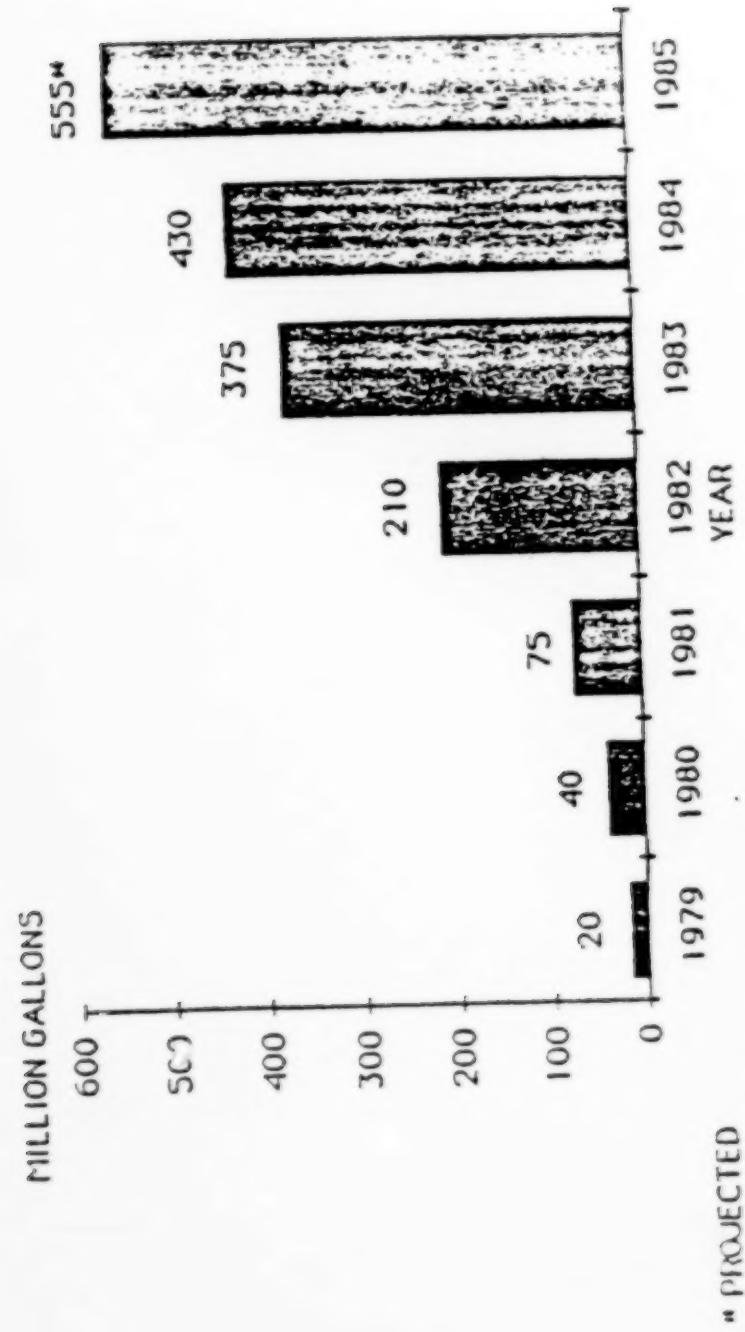
1979 - 1985



SOURCE: INFORMATION RESOURCES INCORPORATED, WASH., D.C.

Exhibit B

# U.S. FUEL ETHANOL PRODUCTION 1979 - 1985



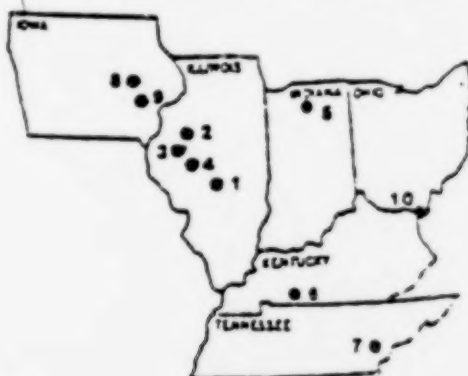
SOURCE: INFORMATION RESOURCES  
INCORPORATED, WASH. D.C.

Exhibit C

ETHANOL ANHYDROUS CAPACITY  
OF MAJOR PLANTS  
(Plants Larger Than 10 mm Gal./Year)

<u>Company</u>	<u>Location City/State</u>	<u>Capacity to Supply IL (GPY)</u>
MAJOR ILLINOIS ETHANOL PRODUCERS		
1) ADM	Decatur, IL	150,000,000
2) ADM	Peoria, IL	90,000,000
3) Pekin Energy	Pekin, IL	70,000,000
4) Midwest Solvents Co.	Pekin, IL	11,000,000
TOTAL ILLINOIS		321,000,000
OTHER MAJOR MIDWEST ETHANOL PRODUCERS		
5) New Energy	South Bend, IN	50,000,000
6) Kentucky AG	Franklin, KY	20,000,000
7) A.E. Staley	Loudon, TN	40,000,000
8) ADM	Cedar Rapids, IA	60,000,000
9) Grain Proc. Corp.	Muscataine, IA	10,000,000
10) South Point	South Point, OH	60,000,000
TOTAL REGIONAL		243,000,000
TOTAL ILLINOIS		321,000,000
TOTAL MIDWEST REGION (IL, IA, IN, OH, KY, TN)		564,000,000

MAJOR MIDWEST ETHANOL PRODUCERS



SOURCE: 1985 U.S. Alcohol Fuels Industry Data Base  
Published by: Information Resources, Incorporated,  
Washington, D.C.

Exhibit D